

72

1 MARC A. LEVINSON (STATE BAR NO. 57613)
 malevinson@orrick.com
 2 NORMAN C. HILE (STATE BAR NO. 57299)
 nhile@orrick.com
 3 JOHN W. KILLEEN (STATE BAR NO. 258395)
 jkilleen@orrick.com
 4 ORRICK, HERRINGTON & SUTCLIFFE LLP
 400 Capitol Mall, Suite 3000
 5 Sacramento, California 95814-4497
 Telephone: (916) 447-9200
 6 Facsimile: (916) 329-4900

7 Attorneys for Debtor
 City of Stockton
 8

9 UNITED STATES BANKRUPTCY COURT
 10 EASTERN DISTRICT OF CALIFORNIA
 11 SACRAMENTO DIVISION
 12

13 In re:
 14 CITY OF STOCKTON, CALIFORNIA,
 15 Debtor.

Case No. 2012-32118
 D.C. No. OHS-1
 Chapter 9

**CITY OF STOCKTON'S REPLY TO
 OBJECTIONS TO ITS STATEMENT
 OF QUALIFICATIONS UNDER
 SECTION 109(C) OF THE UNITED
 STATES BANKRUPTCY CODE**

Date: February 26, 2013
 Time: 1:30 p.m.
 Dept: C
 Judge: Hon. Christopher M. Klein

21
 22
 23
 24
 25
 26
 27
 28

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

TABLE OF CONTENTS

	Page(s)
I. INTRODUCTION	1
II. THE OBJECTORS IGNORE THE CITY’S EXTENSIVE EFFORTS TO AVOID BANKRUPTCY.....	4
A. The City Council Considered And, For Good Reason, Rejected The Central Recommendations Of Assured’s Alternative Model	5
B. The City Based Its AB 506 “Ask” And Its Proposed Fiscal Year 2012-13 Budget On Reasonable Assumptions	9
III. THE CITY IS AN ELIGIBLE DEBTOR UNDER CHAPTER 9 OF THE BANKRUPTCY CODE.....	12
A. The City Is Authorized By California Law To Bring Its Petition (§ 109(c)(2)).....	12
B. The City Is Insolvent (§ 109(c)(3))	15
1. The City Was Unable to Pay Its Bills as They Became Due in Fiscal Year 2012-13.....	17
2. <i>In re Westlake</i> Is Easily Distinguishable.....	22
3. Even Under Assured’s Fallacious Legal Standard, the Zielke and Bobb Reports Would Not Have Ensured the City’s Budget Solvency as of the Petition Date	24
a. The Alternative Model Is Fundamentally Flawed	25
b. The Alternative Model’s Proposed Revenue Increases Were Infeasible	26
c. The Alternative Model’s \$8.85 Million In “Department Budget Reductions” Reflects Only Assured’s Policy Preference To Inflict More Pain On The Community Than the City Council Was Willing To Inflict.....	29
d. The Majority Of The Proposed Savings In “Employee Personnel & Benefits” Are Not Obtainable Outside Of Chapter 9	30
e. The Elimination Of Fiscal Stability Measures Exemplifies The Alternative Model’s Reckless Disregard For Best Practices	32
4. The City’s Finances, Once Unreliable, Are Now Reliable	35
5. No Evidentiary Hearing Is Required To Establish The City’s Insolvency	37
C. The City Desires To Effect A Plan To Adjust Its Debts (§ 109(c)(4))	38
D. The City Has Satisfied The Negotiation Requirements (§ 109(c)(5))	39
1. The City Negotiated in Good Faith With What Creditors It Could (§ 109(c)(5)(B)).....	41
a. The City Was Not Required To Have A Confirmable Plan In Place To Be Eligible For Chapter 9 Relief	41

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

TABLE OF CONTENTS
(cont'd)

		Page(s)
	b. The City’s Participation In The AB 506 Process Satisfied The Requirements Of Section 109(c)(5)	42
	c. The City’s Refusal Unilaterally To Reduce Pension Benefits For Retirees And Current Employees Did Not Constitute A Lack Of Good Faith	45
	(1) Outside of Chapter 9, Neither the City nor CalPERS Could Legally Reduce Pension Benefits for the City’s Retirees and Current Employees	46
	(2) Termination of Its CalPERS Contract Would Immediately Have Plunged the City Deeper Into Insolvency	48
	(3) Electing Not to Unilaterally Modify Pensions or to Further Reduce Wages and Benefits Did Not Demonstrate a Lack of Good Faith	50
	(a) The Only Evidence Demonstrates That Further Wage Cuts Risked Provoking Officer Departures	53
	(b) The Objectors’ Critiques Of The City’s Evidence Are Unfounded And Unreasonable	56
	(c) The Objectors Distort The Grave Reality Of Crime And The Need For Officers In The City	59
	d. No Conflict Of Interest “Tainted” The Ask	61
	2. Alternatively, Negotiation With the City’s Creditors Was Impracticable (§ 109(c)(5)(C)).....	64
	3. No Evidentiary Hearing Is Required to Establish the City’s Compliance With § 109(c)(5)(B) or (C)	65
	E. The City Filed Its Petition In Good Faith (§ 921(c))	65
IV.	CONCLUSION	65

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

TABLE OF AUTHORITIES

Page(s)

FEDERAL CASES

Ass’n of Retired Emps. of the City of Stockton v. City of Stockton (In re City of Stockton, Cal.),
478 B.R. 8 (Bankr. E.D. Cal. 2012) 14, 31

Duvar Apt., Inc. v. FDIC,
205 B.R. 196 (B.A.P. 9th Cir. 1996)..... 23

In re Am. Capital Equip., LLC,
668 F.3d 145 (3d Cir. 2012)..... 62

In re City of Bridgeport,
129 B.R. 332 (Bankr. D. Conn. 1991) 19, 22, 37, 44

In re City of Stockton, Cal.,
475 B.R. 720 (Bankr. E.D. Cal. 2012) 6, 13

In re City of Stockton, Cal.,
_ B.R. _, Dkt. No. 685 at 8 (Bankr. E.D. Cal. Feb. 5, 2013) 6

In re City of Vallejo, Cal.,
No. 08-26813-A-9, 2008 WL 4180008 (Bankr. E.D. Cal. Sept. 5, 2008) passim

In re Coram Healthcare Corp.,
271 B.R. 228 (Bankr. D. Del. 2001) 62

In re Ellicott Sch. Bldg. Auth.,
150 B.R. 261 (Bankr. D. Colo. 1992) 44, 45

In re New York City Off-Track Betting Corp.,
427 B.R. 256 (Bankr. S.D.N.Y. 2010) passim

In re Pierce Cnty. Hous. Auth.,
414 B.R. 702 (Bankr. W.D. Wash. 2009) 22

In re Sullivan County Reg’l Refuse Disposal,
165 B.R. 60 (Bankr. D.N.H. 1994) 42

In re Town of Westlake,
211 B. R. 860 (Bankr. N.D. Tex. 1997)..... 22, 23, 24, 37

In re Unichem Corp.,
72 B.R. 95 (Bankr. N.D. Ill. 1987)..... 62

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

TABLE OF AUTHORITIES
(cont'd)

Page(s)

In re Valley Health Sys.,
383 B.R. 156 (Bankr. C.D. Cal. 2008)..... 12, 41, 64

In re Victory Constr. Co.,
9 B.R. 549 (Bankr. C.D. Cal. 1981)..... 23

Int’l Ass’n of Firefighters, Local 1186 v. City of Vallejo (In re City of Vallejo),
408 B.R. 280 (B.A.P. 9th Cir. 2009)..... passim

Newhouse v. Corcoran Irrigation Dist.,
114 F.2d 690 (9th Cir. 1940)..... 44

Retired Emps. Ass’n of Orange Cnty., Inc. v. County of Orange,
No. 12-56706 (9th Cir. Sept. 6, 2012) 31, 64

Sonoma Cnty. Ass’n of Retired Emps. v. Sonoma Cnty.,
No. 09-4432 (N.D. Cal. Sept. 22, 2009) 31

Sonoma Cnty. Ass’n of Retired Emps. v. Sonoma Cnty.,
No. 10-17873 (9th Cir. Dec. 22, 2010) 31, 64

OTHER CASES

Aronson v. Lewis,
473 A.2d 805 (Del. 1983) 63

Cal. Ass’n of Prof’l Scientists v. Schwarzenegger,
137 Cal. App. 4th 371 (2006)..... 46

City of Oakland v. Pub. Emps.’ Retirement Sys.,
95 Cal. App. 4th 29 (2002)..... 47

In re Walt Disney Co. Deriv. Litig.,
906 A.2d 27 (Del. 2006) 63

Mills Acquisition Co. v. Macmillan, Inc.,
559 A.2d 1261 (Del. 1989) 63

FEDERAL STATUTES

11 U.S.C.
§ 101(32) 2, 15

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

TABLE OF AUTHORITIES
(cont'd)

	Page(s)
§ 109(c)	passim
§ 921(c)	65
§ 943.....	41

OTHER STATUTES, RULES, REGULATIONS

Cal. Code Regs., Title 2, § 18232(a).....	61
Cal. Gov't Code	
§ 20281.....	62
§ 20460.....	50
§ 20474.....	47
§ 20475.....	47
§ 20502.....	62
§ 20506.....	47
§ 20570.....	49
§ 20572.....	49
§ 20574.....	48, 49
§ 53760.1.....	13
§ 53760.3.....	12, 13, 45
§ 53760.....	43
§ 87100.....	61
§ 87103.....	61
§ 82030.....	61

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

TABLE OF AUTHORITIES
(cont'd)

Page(s)

OTHER AUTHORITIES

85 Ops. Cal. Atty. Gen. 6, 2002 WL 32457 (Cal. A.G., Jan. 10, 2002) 61

Collier on Bankruptcy, ¶ 943.03[1][f][i][B] 44

Diana Marcum, *Stockton Council Candidate Never Forgot Where He Came From*, L.A. TIMES, Nov. 4, 2012, available at 2012 WLNR 23408357 40

Michael Fitzgerald, *City Has Been Paying Illegal Benefits For Years*, STOCKTON RECORD, Apr. 25, 2012 61

1 **I. INTRODUCTION**

2 Two days after filing this chapter 9 case, the City of Stockton (“City”) filed a lengthy
 3 memorandum, supported by six declarations, demonstrating why the City was eligible for chapter
 4 9 relief.¹ The declarations were backed by exhibits that aggregated hundreds of thousands of
 5 pages. Three weeks later, following this Court’s ruling on the introduction of evidence relating to
 6 the so-called AB 506 process, the City filed four additional declarations and exhibits. About two
 7 weeks after that, three creditors filed preliminary objections to eligibility.²

8 Months of time-consuming and very expensive discovery followed. In addition to
 9 producing many public records, the City produced 200,000 pages of documents, including
 10 thousands of emails. The Objectors then deposed seven of the City’s declarants, plus the City
 11 Manager, Robert Deis, and Vice Mayor Kathy Miller. In mid-December, Assured and National
 12 filed their supplemental objections to eligibility. Franklin and Wells Fargo filed joinders. The
 13 Objectors also filed the declarations of four alleged experts, each of whom submitted a report.
 14 Thereafter, the Objectors produced some documents and the City deposed the four experts. This
 15 reply responds to the preliminary and supplemental objections, and to the four declarations. It is
 16 supported by seven declarations that address the contentions of the Objectors and their hired
 17 declarants. It builds upon the Memorandum rather than supersedes it, such that where a topic is
 18 discussed in detail in the Memorandum and only mentioned or discussed in passing in the
 19 Objections—such as impracticability (i.e., Bankruptcy Code § 109(c)(5)(C))—the discussion
 20 herein is truncated in deference to the discussion in the Memorandum.

21 After all the delay, after all the legal and consulting fees, after all the depositions and
 22 produced documents, and after all the pages of legalese in the various memoranda of law, how
 23 many complex issues of fact and law does the Court have to decide in order to find that the City is
 24 eligible for chapter 9 relief? The answer is few, if any. Boiled down, there are three objections.

25 ¹ See City of Stockton’s Memorandum of Fact and Law in Support of Its Statement of Qualifications Under Section
 26 109(c) of the United States Bankruptcy Code [Dkt. No. 19] (the “Memorandum”).

27 ² The three are: (1) Assured Guaranty Corp. and its affiliate Assured Guaranty Municipal Corp. (together,
 28 “Assured”); (2) National Public Finance Guaranty Corporation (“National”); and (3) Franklin Advisers, Inc.
 (“Franklin”). Wells Fargo Bank, National Association, as indenture trustee (“Wells Fargo”), joined in the
 preliminary objections, as instructed by Assured, National and Franklin. Wells Fargo and the other three are referred
 to herein collectively as the “Objectors” or the “Capital Markets Creditors.”

1 First (briefed only by Assured, but joined by Franklin and Wells Fargo without elaboration): Was
2 the City insolvent on the petition date (as the term insolvent is defined in Bankruptcy Code §
3 101(32)(C))? Second: Did the City act in good faith during the AB 506 process and generally by
4 failing to seek pension concessions and/or additional concessions from the members of its nine
5 unions and its retirees? Third: Assuming that any prebankruptcy negotiation was not
6 impracticable, did the City's 790-page Ask produced for and during the AB 506 process satisfy
7 the good faith negotiation requirement of Bankruptcy Code § 109(c)(5)(B)?

8 The answer to each of these questions is unequivocally: "Yes." In summary:

9 ***Insolvency.*** The test is whether the City was insolvent on the petition date, not whether
10 the Court agrees with what some hired gun opines the City should have done to avoid insolvency
11 prior to the petition date. This Court already has issued two opinions about the limitations
12 imposed by the Tenth Amendment and the Bankruptcy Code on its power to make financial or
13 governmental decisions for the City. The Objectors would have the Court bar the City from
14 bankruptcy relief because of decisions the City made before filing its petition. They would have
15 the Court rule that if the City merely reduced its workforce or somehow cut back on pension
16 benefits, it might have avoided the bankruptcy filing. In other words, they think they know how
17 to run the City better than the City Council does, and ask the Court to validate their armchair
18 quarterbacking. Judge McManus outright rejected that notion in the *City of Vallejo* case, and this
19 Court should do so here. And it should do so without conducting an evidentiary hearing on the
20 validity of the conclusions in the expert reports. While the City addresses those reports in detail
21 herein and demonstrates that the assumptions are flawed, the methodology sloppy, and the
22 conclusions invalid, the Court need not even go there. It should rule as a matter of law that what
23 a third party—or even the Court—would have done if it were making decisions for the City is
24 legally irrelevant to whether the City could pay its debts as they came due on June 28, 2012 or
25 within the fiscal year that began three days later. The evidence is both overwhelming and
26 uncontradicted that the City was insolvent.

27 ***Good Faith.*** Due in no small part to the AB 506 process conducted by Judge Ralph
28 Mabey and the postbankruptcy mediation conducted by Judge Elizabeth Perris, the City has

1 reached agreements with its nine labor unions. As discussed in detail in the Memorandum and in
2 this reply, prior to bankruptcy the City had downsized its workforce to the point that it was not
3 delivering even a basically adequate level of services to its residents. Its workers had voluntarily
4 given up post-employment health benefits and their compensation had been reduced to less than
5 that paid by comparable cities. As a result of those staffing, compensation and benefits
6 reductions, the City had experienced the loss of an extraordinary number of employees. The
7 leaders of the City determined that seeking additional reductions generally, or seeking to become
8 the first city in California to unilaterally reduce pension benefits, would destroy the morale of the
9 workforce, would cause workers—particularly experienced police officers—to look for
10 employment elsewhere, and would exacerbate the suffering of a city grappling with historically
11 high murder and violent crime rates. While the Objectors (who are based in New York, Boston
12 and the San Francisco Peninsula) might be willing to run the risk that the City would become
13 ungovernable and that its residents/taxpayers might flee, the City decision-makers were unwilling
14 to take that risk. This Court should not conclude that the City’s decision to take the steps
15 necessary to preserve its workforce was not a decision made in good faith.

16 The City submits that the Ask is prima facie evidence of its good faith, as are the
17 numerous mediation sessions conducted by Judge Ralph Mabey during the AB 506 process. The
18 agreements reached with the City’s unions during that process are further proof. And while the
19 Capital Markets Creditors did not care for the treatment proposed for them in the Ask, the fact is
20 that the Ask was the product of hundreds of hours of work by a team of City staff and outside
21 professionals, and it represented what the City believed and believes was the best approach to the
22 City’s massive financial problems. That neither Assured nor National chose to submit
23 counterproposals to the Ask during the AB 506 process does not implicate the City’s good or bad
24 faith. But what does reflect on the City’s good faith is that it not only made a thoughtful Ask of
25 its creditors, but it also funded 100% of the costs of the AB 506 process because the Capital
26 Markets Creditors refused to pay their share.

27 ///

28 ///

1 **Bankruptcy Code § 109(c)(5)(B) Negotiation Requirement.** The Ask addresses each
2 class of the City’s creditors and proposes a detailed treatment for each. At 790 pages, it is much,
3 much more than the term sheet that the Bankruptcy Appellate Panel thought necessary in the *City*
4 *of Vallejo* case. That the Capital Markets Creditors dislike the Ask, because in their view it is too
5 harsh on them and too kind to labor, has no bearing on whether the terms of the Ask satisfied
6 Bankruptcy Code § 109(c)(5)(B). Nor do the Bankruptcy Code or the precedents require that the
7 pre-bankruptcy plan discussions be premised on an airtight, slam dunk, confirmable chapter 9
8 plan of adjustment. If that were the case, every chapter 9 petition would have to be accompanied
9 by a plan. The Court need not conduct an evidentiary hearing on whether the City satisfied
10 Bankruptcy Code § 109(c)(5), as there is no dispute over whether the City submitted the Ask and
11 because the Ask speaks for itself.

12 **II. THE OBJECTORS IGNORE THE CITY’S EXTENSIVE EFFORTS TO AVOID**
13 **BANKRUPTCY.**

14 In the Objectors’ eyes, in early 2012 the City woke up from years of slumber to find itself
15 in a minor fiscal bind. It sat on a pile of money and enjoyed safe streets, well-maintained
16 facilities, and abundant civic amenities. To solve its fiscal challenges, all it had to do was “put
17 everything on the table” and pick from a “menu” of budget reduction options. These options
18 carried no risks, were practically and legally feasible, and could be achieved instantly. Even
19 better, none of them would inflict “material” harm on the City and its residents as a community.
20 But instead of taking these few painless steps to balance its budget, the City Council, solely to
21 avoid debt obligations to a few bond insurers and a well-heeled investment fund, treated itself to
22 the chapter 9 luxury “resort” by entering the AB 506 process and becoming the largest city in
23 California history to seek bankruptcy relief.

24 The Objectors’ revisionist history is nothing more than a fairy tale. The hard truth is that
25 the City had been suffering financially for years, was well aware of its economic problems, and
26 had taken many painful measures to shore up its finances, including much of the “heavy lifting”
27 Assured claims was lacking. Assured’s glib assertion that its proposed 15% across-the-board cuts
28 and other measures would not inflict “material” harm on the City and its residents is a value

1 judgment that the City Council, not Assured, is entitled to make. The harm well might not seem
 2 “material” to a multi-billion-dollar financier headquartered 3,000 miles away. But the City
 3 Council deemed it “material” on February 28, 2012, when, after having already cut its General
 4 Fund budget by 36% the prior three years, it decided it could not countenance any further service
 5 reductions and that it had no choice but to enter the AB 506 process.

6 **A. The City Council Considered And, For Good Reason, Rejected The Central**
 7 **Recommendations Of Assured’s Alternative Model.**

8 As demonstrated in the Memorandum, the City experienced a historically unprecedented
 9 collapse in revenues after the country’s housing bubble burst, suddenly leaving the City a national
 10 leader in foreclosures and cementing its position as a national leader in crime, unemployment,
 11 and illiteracy. Declaration of Laurie Montes [Dkt. No. 23] (“Montes Decl.”), ¶¶ 6-16, 31;
 12 Declaration of Eric Jones [Dkt. No. 30] (“Jones Decl.”), ¶ 9. For three years in a row, the City
 13 projected, confronted, and closed annual deficits of over \$20 million. Montes Decl., ¶¶ 3, 17-26.
 14 To do so, the City Council managed to create \$90 million worth of aggregate savings. This
 15 process compelled the City to make difficult political decisions, including:

- 16 - Reducing non-public safety staffing by 43%, which necessarily resulted in harm to
 17 core City functions like finance and information technology, Montes Decl., ¶ 20;
- 18 - Reducing sworn police staffing by 25%, notwithstanding that violent crime was
 19 spiking upward, *id.*; Jones Decl., ¶ 9;
- 20 - Reducing fire staffing by 30% while leaving in service fire engines that were so far
 21 beyond their useful lives that mechanics had to accompany fire crews on service calls,
 22 Montes Decl., ¶¶ 9, 28;
- 23 - At significant legal risk, aggressively negotiating and unilaterally reducing what had
 24 been above-market employee compensation and benefits, to the point that the City
 25 now offers compensation that is at or below market rates, and where individual
 26 employees have taken as much as a 30% decrease in their take-home pay, *id.* ¶¶ 19,
 27 22; Declaration of Ann Goodrich [Dkt. No. 20] (“Goodrich Decl.”), ¶¶ 5-6, 11-12 &

1 Ex. A; Reply Declaration of Ann Goodrich (“Goodrich Reply Decl.”), ¶¶ 4-11 & Exs.
2 A-D;

- 3 - Closing a community center and reducing hours at a senior center, Montes Decl., ¶ 31;
4 - Reducing recreation classes, after-school programs, and library programs targeted at
5 at-risk schoolchildren, *id.* ¶ 31; this was of particular concern because such programs
6 serve not only a quality-of-life function but also reduce crime among the young, Reply
7 Declaration of Robert Deis (“Deis Reply Decl.”), ¶ 13; Reply Declaration of Norman
8 C. Hile (“Hile Reply Decl.”), Ex. A, pp. 139:25-140:11, 142:4-11;
- 9 - Closing a library branch, reducing library hours by 48%, and reducing funding for
10 books and materials by 50%, Montes Decl., ¶ 31; like after-school programs, libraries
11 may be a “nice-to-have” in affluent communities, but serve a vital role in a city with
12 one of the highest illiteracy rates in the country, *id.*; Deis Reply Decl., ¶ 12;
- 13 - Not replacing city vehicles which were beyond their useful lives, Montes Decl., ¶ 30;
14 and
- 15 - Deferring the maintenance of roads, trees, parks, libraries, and city buildings. *Id.*

16 While Assured and its purported experts would have the Court ignore these measures,
17 “context matters”³ in understanding why the City Council subsequently acted as it did leading up
18 to filing of the City’s chapter 9 petition. For despite having made difficult choices for three years,
19 in early 2012 the City faced a \$25 to \$38 million deficit for the upcoming 2012-13 fiscal year,
20 which began July 1, 2012. Montes Decl., ¶ 41.

21 The City knew it was at a breaking point. In addition to relying on its own numbers, the
22 City retained Management Partners, a firm of experienced local government experts, to provide a
23 “second opinion” of the City’s financial condition. Montes Decl., ¶ 34; Deis Reply Decl., ¶ 31.
24 Unlike Assured’s experts, Management Partners conducted a real-time, on-the-ground study.
25 Management Partners spent time in the City and interviewed key City personnel, including the
26 City Manager, City Attorney, Chief Financial Officer, and Police and Fire Chiefs. Montes Decl.,
27

28 ³ *In re City of Stockton, Cal.*, 475 B.R. 720, 724 (Bankr. E.D. Cal. 2012); *see also In re City of Stockton, Cal.*, _ B.R. __, Dkt. No. 685 at 8 (Bankr. E.D. Cal. Feb. 5, 2013).

1 Ex. P, p. 11. In February 2012, Management Partners produced a report, *id.*, which Assured's
2 own expert Robert Bobb praised at his deposition as "an excellent comprehensive analysis of
3 where the City stood." Hile Reply Decl., Ex. A, pp. 100:21-101:2.

4 In its report, Management Partners determined that the City was "insolvent from a service
5 delivery perspective," which it defined as a "municipality's ability to pay for all the costs of
6 providing services at the level and quality that are required for the health, safety, and welfare of
7 the community." Montes Decl., Ex. P, p. 18. It also determined that with "major expenditure
8 reductions already in place, further financial restructuring must occur to prevent budget and cash
9 insolvency." *Id.* p. 22.

10 Though it was not the primary purpose of its report, Management Partners was fully aware
11 of and considered potential revenue sources like tax measures and increasing collections from the
12 City's fee program. Montes Decl., Ex. P, pp. 42, 47. On the expenditure side, the report
13 recognized the need to explore options like "other service providers that could be contacted for
14 proposals to maintain services at lower costs." *Id.* p. 46. Unlike Assured's experts Bobb and
15 Nancy Zielke, however, Management Partners accounted for the feasibility of such measures,
16 including timing and resource constraints. So while recognizing that new revenues would be
17 essential to the City's long term viability, Management Partners concluded that the City was
18 "unlikely to win support for new revenue[] [measures] because of public concern about the
19 problems discovered by the staff and City Council since July 1, 2010." *Id.* p. 35. More
20 fundamentally, Management Partners concluded that while revenue enhancement and expenditure
21 reductions were important and should be analyzed, the higher priority was to ensure the City's
22 immediate cash solvency and to prevent an uncontrolled cash default—a prioritization decision
23 that Zielke and Bobb do not address, let alone dispute. *Id.* pp. 7 ("All legally available cash will
24 be needed by the General Fund to deal with the City's solvency risks"), 43.

25 At its February 28, 2012 meeting, the City Council reviewed the Management Partners
26 report and a staff report that provided detailed information about the City's financial situation,
27 including a section on "Options for Closing Gap." Montes Decl., Ex. Q, p. 251.26. Here,
28 contrary to what Zielke and Bobb erroneously claim, staff examined, and the City Council

1 considered, many of the options that Zielke and Bobb claim should have been examined. But
 2 unlike Zielke and Bobb, the Council used realistic assumptions about feasibility and timing. For
 3 example, staff evaluated the feasibility of tax increases, the centerpiece of the Zielke revenue
 4 plan. *Id.* Staff concluded that because of the City’s economic condition and the City’s past
 5 history of poor decisions and sloppy practices, Stockton residents were unlikely to approve new
 6 revenues, a judgment later borne out in polling conducted by the City. *Id.*; *see infra* Section
 7 III(B)(3)(b). Staff suggested that a better route was for the City to “seek additional revenues to
 8 support a restructured, sustainable organization.” Montes Decl., Ex. Q, p. 251.26.

9 After hearing hours of staff and consultant testimony and community input on the staff
 10 report, the Management Partners report, and the options available, the City Council accepted
 11 Management Partners’ and staff’s recommendation to enter the AB 506 process. Montes Decl., ¶
 12 42 & Ex. R. Consistent with Management Partners’ finding that the City was “service insolvent,”
 13 the members of the City Council, as the representatives of the citizens of Stockton, decided not to
 14 authorize further service cuts. Montes Decl., Exs. P-R. Presciently, Mayor Ann Johnston
 15 anticipated the Zielke Report’s recommendation to cut another \$24 million from City department
 16 budgets by a further 15% across-the-board reduction:

17 We will not cut services, or we will try not to cut services any
 18 further. We’ve cut to the bone on police and on fire and other
 19 services. This Council—certainly myself—we’re not ready to do
 20 that. The safety of our citizens is more important. We need to
 21 preserve the services we have because we’ve cut so far to this point.
 We don’t want to go there. We could say we’ll find another \$20
 million dollars. We’ll just cut a bunch more police officers, a
 bunch more people. That’s not where we want to go.

22 Hile Reply Decl., Ex. B.

23 Vice Mayor Katherine Miller was in accord: “We’ve reduced our services to a level that I
 24 don’t think anyone who lives in the City thinks is acceptable.” Hile Reply Decl., Ex. B.

25 Councilmember Diana Lowery likewise commented, “To continue what we’ve been
 26 doing, and make cuts after cuts after cuts; we can’t do it. . . . I’ve been doing it since I arrived
 27 here, and we simply can’t continue to exist.” Hile Reply Decl., Ex. B.

28 ///

1 Mayor Johnston also echoed Management Partners' and staff's concern about attempting
2 to ask citizens to approve tax hikes: "We don't believe that until we get our house in order is
3 anyone going to approve any kind of tax in this city." Hile Reply Decl., Ex. B.

4 Based on these concerns, the City Council adopted the Management Partners report and
5 the staff recommendations and voted to enter the state-mandated "neutral evaluation process" (or
6 "AB 506 process"), which the City initiated the next day. Montes Decl., ¶ 42 & Ex. R. To avoid
7 uncontrolled cash default before the end of the fiscal year, the City Council also adopted a series
8 of legally risky measures, including not making certain bond payments and deferring payments to
9 separating employees. *Id.* ¶¶ 38-39.

10 **B. The City Based Its AB 506 "Ask" And Its Proposed Fiscal Year 2012-13**
11 **Budget On Reasonable Assumptions.**

12 During the AB 506 process, the City prepared and distributed to all creditors its "Ask."
13 Declaration of David Millican [Dkt. No. 454] ("Millican Decl."), ¶¶ 2-3, Ex. A. The Ask detailed
14 the City's short-term cash position and long-term budget projections. Since the purpose of the
15 AB 506 process was to provide a venue for restructuring the City's debts, the City also included a
16 detailed restructuring proposal for each of the City's major creditors. *Id.*

17 Parallel to the Ask, on or around May 15, 2012, City staff submitted to the City Council a
18 proposed budget for fiscal year 2012-13. Declaration of Vanessa Burke ("Burke Decl.") [Dkt.
19 No. 62], ¶ 21 & Ex. D. The proposed budget confirmed what the City already knew, namely, that
20 it could not close its \$26 million "gap" and balance its budget. *Id.* ¶ 11. Its anticipated revenues
21 remained depressed. *Id.* ¶¶ 22-26, Ex. F. And while it had already made across-the-board
22 reductions in employee costs, the costs of healthcare, pensions, and debt service in particular were
23 trending upward. *Id.* ¶¶ 37-40, Ex. G.

24 Significantly, Zielke adopts nearly wholesale the City's May 15 proposed budget as her
25 baseline. Declaration of Nancy L. Zielke ("Zielke Decl."), Ex. B [Dkt. No. 640], p. 46. She does
26 not challenge, for example, the City's projections of its major revenue streams: sales tax, property
27 tax, or utility user tax. Similarly, on the expenditure side, by and large Zielke does not quarrel
28 with the City's projection of its General Fund costs—employee compensation, pension, or

1 healthcare. Instead, Zielke presents a “Budget Alternative Model” (the “Alternative Model”) that
2 prescribes policy choices different than those adopted by the City Council on February 28. Zielke
3 Decl., Ex. B, p. 47. The Alternative Model assumes that the City would have (1) placed before
4 City voters and had them pass tax measures to provide an additional \$8.3 million in revenue, (2)
5 cut another 15% from all non-safety departments, and (3) potentially violating the law,
6 unilaterally reduced retiree medical payments and employee costs. *See infra* Section III(B)(3).
7 The Alternative Model is an alternative to, not a refutation of, the City Council’s February 28,
8 2012 discussions and the May 15 proposed budget.

9 The presentation of the May 15 budget only confirmed that with little left to cut and
10 services at dangerously low levels, the only path to solvency for the City was for it to restructure
11 its financial obligations either through the AB 506 process or through bankruptcy. Accordingly,
12 on June 5, 2012, the City Council authorized the City Manager to file a chapter 9 petition if the
13 AB 506 process were unsuccessful in restructuring the City’s obligations. Montes Decl., ¶ 46 &
14 Ex. U. Again, the City Council focused on the fragile state of the community and its inability to
15 weather any further service reductions:

16 We’ve sat here year after year and had to cut everything. There’s
17 been almost no part of this organization that hasn’t felt the brunt of
18 this recession. And if we go beyond this year and look at another
19 deficit next year, we will quite literally be engaging in the
dismantling of this city organization. There will not be an
organization left to provide services to the people who live here.

20 Hile Reply Decl., Ex. C (comments of Vice Mayor Miller). Two weeks later, on June 26,
21 2012, the City adopted a Pendency Plan budget, which was contingent on the filing of the City’s
22 chapter 9 petition two days later. Burke Decl., ¶ 50.

23 In sum, contrary to what Zielke and Bobb insinuate, the City’s decision to enter the AB
24 506 process and file its chapter 9 petition was neither thoughtless nor unreasoned. After years of
25 imposing painful service reduction after painful service reduction, the City Council made the
26 decision that the City could cut no more. And it believed, with good reason, that voter-approved
27 revenue measures that could be implemented before the end of fiscal year 2012-13 were
28 infeasible. It also believed that long-term measures to prevent chronic insolvency and

1 uncontrolled default were likely to fail if services and public safety were not improved and if the
2 City had not made a compelling case to its citizens that it had put its financial house in order.

3 In moments of honesty, Assured's experts acknowledge the difficulty of the decisions
4 already made by the City Council. *See* Hile Reply Decl., Ex. A, pp. 90:3-17 (Bobb agreeing that
5 "as of October 2011, the City had demonstrated leadership through tightening spending and
6 focusing scarce resources on the most critical programs"), 83:8-11 (City's past cuts to public
7 safety were "as much as [Bobb] felt that [] could possibly be made"). They likewise
8 acknowledge the value to the City of what they would characterize as "nice to haves." *See* Hile
9 Reply Decl., Ex. A, pp. 138:7-139:1 (Bobb agreeing that "programs that are not simply police
10 related can have the effect of reducing crime" and that such programs "make[] the City liveable"),
11 139:25-140:11 (affirming "a direct correlation" between recreation services and crime), 140:12-
12 21 (confirming that "all of those services [community policing, recreational programs, and library
13 services] are important to having a viable city and a viable community"), 142:4-11 (calling after-
14 school programs "a contributor for crime reduction"); Hile Reply Decl., Ex. D, pp. 93:1-3,
15 205:23-24 (Zielke recognizing that "providing for health and safety and quality of life are
16 important to local governments" and that "[l]ibrary services is [sic] important to a community").
17 And they further admit that sometimes service cuts simply go too far. *See* Hile Reply Decl. Ex.
18 A, pp. 233:10-15 (Bobb recognizing that "there may be a point where you can't cut anymore"
19 because "you still have to provide the public with the services that the agency is supposed to
20 provide"), 150:4-17 (there was "no fat left to cut" in a 2003 Oakland budget that, despite
21 including cuts to public safety, left libraries, recreation and senior centers open).

22 At the same time, though, Bobb and Zielke parrot the line that the City has not "put all the
23 options on the table," "rolled up its sleeves," thrown out "the standard financial crisis playbook,"
24 or "cleared away the great ideas of the past that time has passed by" and the "shibboleths that
25 have prevented fundamental change." Hile Reply Decl., Ex. A, p. 40:8-12; Hile Reply Decl., Ex.
26 D, p. 233:13-17; Declaration of Robert C. Bobb [Dkt. No. 641] ("Bobb Decl."), ¶ 6 & Ex. B [Dkt.
27 No. 642], p. 31. While catchy sound bites, such phrases are no more meaningful than the patter
28 of a self-help guru peddling his latest book. The City's elected leaders, having considered the

1 advice of staff and independent experts and having deliberated in open session and received
2 public input, determined that the City simply could not cut many more services and remain
3 viable.⁴

4 As demonstrated thoroughly below, Assured’s Alternative Model would have been
5 impossible to effectuate in time to avert cash insolvency—which is exactly why Management
6 Partners recommended that the City *first* preserve cash solvency and *then* address revenue and
7 expense reduction opportunities. *See supra* Section II(A). All Assured’s experts do is second-
8 guess the City Council’s informed choices, arrogate the Council’s political authority, and tell the
9 City Council and the City’s 300,000 residents, “you should have cut more,” consequences be
10 damned, so long as the City could continue to make its debt service payments unabated. The
11 City’s refusal to follow Assured’s after-the-fact approach does not mean that the City was solvent
12 or that its chapter 9 filing was not in good faith.

13 **III. THE CITY IS AN ELIGIBLE DEBTOR UNDER CHAPTER 9 OF THE**
14 **BANKRUPTCY CODE**

15 The Court should construe chapter 9’s eligibility criteria “broadly to provide access to
16 relief in furtherance of the Code’s underlying policies.” *Int’l Ass’n of Firefighters, Local 1186 v.*
17 *City of Vallejo (In re City of Vallejo)*, 408 B.R. 280, 288 (B.A.P. 9th Cir. 2009) (quoting *In re*
18 *Valley Health Sys.*, 383 B.R. 156, 163 (Bankr. C.D. Cal. 2008)). In the Memorandum, the City
19 enumerated how it satisfied each prong of 11 U.S.C. § 109(c) by a preponderance of the evidence.
20 Nothing said by the Objectors or their experts successfully refutes the City’s showing.

21 **A. The City Is Authorized By California Law To Bring Its Petition (§ 109(c)(2)).**

22 In the Memorandum, the City explained how it participated in the AB 506 process
23 between February 2012 and June 2012. Mem. 17-19. At the time it filed the Memorandum in
24 late June, however, state law prohibited the City from submitting evidence of “statements made,
25 information disclosed, or documents prepared or produced, during the neutral evaluation
26 process.” *See* Cal. Gov’t Code § 53760.3(q). Pursuant to section 53760.3(q)(2) and concurrently

27 _____
28 ⁴ In contrast with Bobb and Zielke, who “made no judgment as to the importance of those services to the City” when suggesting service reductions. Hile Reply Decl., Ex. A, p. 53:5-6.

1 with its chapter 9 petition, the City sought an order allowing it to submit additional evidence of its
2 good faith participation in the neutral evaluation process. Dkt. No. 16; *see In re City of Stockton,*
3 *Cal.*, 475 B.R. 720, 724 (Bankr. E.D. Cal. 2012). On July 13, 2012, the Court issued an opinion
4 and order permitting the City to file its “Ask” and other materials. *Id.* at 733. The City filed this
5 evidence on July 20, 2012. *See* Millican Decl.; Declaration of Connie Cochran [Dkt. No. 453]
6 (“Cochran Decl.”); Supplemental Declaration of Ann Goodrich [Dkt. No. 451] (“Goodrich Supp.
7 Decl.”); Declaration of Marc A. Levinson [Dkt. No. 452] (“Levinson Decl.”).

8 At the same time, though, the Court issued a limited protective order that effectively
9 maintained the secrecy of “the statements made, information disclosed, or documents prepared or
10 produced, during the neutral evaluation process.” 475 B.R. at 733. Subsequently, on November
11 11, 2012, the Court amended its earlier order to permit the parties to disclose additional AB 506
12 information. *See* Dkt. No. 608.

13 The Objectors do not dispute that the City complied fully with the technical requirements
14 of the neutral evaluation process. *See* Cal. Gov’t Code § 53760.3. They question only the City’s
15 “good faith,” which state law defines as “participation by a party in the neutral evaluation process
16 with the intent to negotiate toward a resolution of the issues that are the subject of the neutral
17 evaluation process, including the timely provision of complete and accurate information to
18 provide the relevant parties through the neutral evaluation process with sufficient information, in
19 a confidential manner, to negotiate the readjustment of the municipality’s debt.” Cal Gov’t Code
20 § 53760.1(d). The Objectors assert that the City (i) lacked “intent to negotiate toward a resolution
21 of the issues that are the subject of the neutral evaluation process” and that it (ii) did not provide
22 “complete and accurate information.” Assured Prelim. Obj. 19.

23 The evidence now before the Court proves otherwise. The Ask is prima facie evidence of
24 its desire to “negotiate toward a resolution.” *See* Millican Decl., Ex. A. The Ask contained: (1)
25 an 18-page description of the City’s financial condition and how it arrived there⁵; (2) a five-page
26 framework for its proposals to creditors, which framework described the principles underlying the
27 City’s approach to each class/group of creditors; (3) 26 pages of proposals specific to each of the

28 ⁵ As noted below in Section III(B)(1), neither Zielke nor Bobb disputes this financial condition.

1 City's major creditor groups; and (4) 729 pages of detail and data supporting its financial, labor,
2 retiree, and debt proposals. *Id.* A cursory review of the Ask reveals a thoughtful, thorough plan
3 with reasonable assumptions. While the Objectors may disagree with the City's approach to
4 them, the Ask cannot seriously be characterized as a lack of good faith or a failure to provide
5 sufficient information.

6 Also reflecting the City's desire to negotiate a non-bankruptcy resolution were its efforts
7 to engage with every willing party. *See* Levinson Decl., ¶¶ 2-5 & Exs. A and B; Goodrich Supp.
8 Decl., ¶¶ 2-6 & Exs. A and B. Between March 21, 2012, and June 25, 2012, the City met with
9 virtually every constituency over dozens of meetings: labor, retirees, and debt holders/insurers.
10 *Id.* These efforts led to new agreements with the City's labor groups, which agreements hewed
11 closely to what the City proposed in the Ask. *See* Millican Decl., Ex. A, pp. 24-36; Goodrich
12 Supp. Decl., ¶¶ 2-6; Goodrich Reply Decl., ¶¶ 2-8. They also laid the groundwork for perhaps the
13 most serious impairment proposed in the Ask: the elimination of the City's unfunded and
14 financially crippling retiree medical program, cuts the City unilaterally imposed shortly after
15 filing its chapter 9 petition. *See* Millican Decl., Ex. A, pp. 37-41; Burke Decl., Ex. M; *Ass'n of*
16 *Retired Emps. of the City of Stockton v. City of Stockton (In re City of Stockton, Cal.)*, 478 B.R. 8
17 (Bankr. E.D. Cal. 2012).

18 Further reflecting the City's good faith, and as a prerequisite to these negotiations, the
19 City provided all parties with ample information to evaluate its proposals. The Ask contains
20 extremely detailed, creditor-specific data. It explains the City's rationale, class by class. The
21 City also set up a secure file-sharing website and provided access to all the participants in the AB
22 506 process. Cochran Decl., ¶ 2. On this website, the City posted a total of 2,816 secure files.
23 *Id.* ¶ 3. These files contained information about, among other things, the City's financial
24 condition and budget information. *Id.* On top of all this, the City also posted numerous public
25 records relating to the AB 506 process on its public website
26 (www.stockton.gov.com/ab506publicrecords). *Id.* ¶ 4. The Objectors might quibble with the
27 proposed treatment of them individually, but they are conspicuously silent about what other
28

1 information or data the City could have produced to enable them and the City's other creditors to
2 better evaluate the City's proposal.

3 Distilled, the Objectors' only real quarrel with the City's conduct during the AB 506
4 process is that the City did not "seek concessions" from CalPERS. National Obj. 6. As a matter
5 of law, the omission from the Ask of concessions from CalPERS did not constitute a lack of good
6 faith under federal or state law, *see infra* Section III(D)(1), as Assured tacitly concedes by leaving
7 CalPERS obligations untouched in its Alternative Budget Model. Rather, all the evidence before
8 the Court demonstrates that the City complied to the letter with the requirements of an untested
9 "neutral evaluation" system in AB 506. It also complied with the spirit of the law by devoting
10 significant time and a substantial amount of money at a time when both were scarce commodities.
11 It thereby satisfied California's only pre-filing prerequisite and is authorized by California law to
12 seek chapter 9 relief.

13 **B. The City Is Insolvent (§ 109(c)(3)).**

14 A municipality is insolvent if it is not paying its bona fide debts as they come due or is
15 unable to do so. *See Int'l Ass'n of Firefighters, Local 1186, v. City of Vallejo (In re City of*
16 *Vallejo)*, 408 B.R. 280, 289 (B.A.P. 9th Cir. 2009); 11 U.S.C. § 101(32)(C)(i) and (ii); Mem. p.
17 23:12-22. Importantly, the focus of this prospective analysis is cash solvency, not whether the
18 municipality's budget is balanced. Mem. p. 23:15-16. The City is insolvent if the City's General
19 Fund is out of cash and thus not "able to pay its bills as they become due" in the upcoming fiscal
20 year. *Id.* p. 23:23.

21 It is undisputed that unless it filed this chapter 9 petition prior to the commencement of
22 the 2012-13 fiscal year, the City would have been unable to pay its bills as they became due
23 during the fiscal year starting July 1, 2012. The City filed its petition on June 28, 2012 (the
24 "Petition Date"), when it had less than \$2 million in unrestricted cash on hand. Burke Decl., ¶ 12,
25 Ex. C; Reply Declaration of Vanessa Burke ("Burke Reply Decl."), ¶ 3. The City's
26 uncontroverted evidence demonstrates that the City would not have been able to meet its first
27 payroll of the fiscal year in July 2012. Burke Reply Decl., ¶ 4. Nor would it have been able to
28

1 pay its other bills as they became due during each month in the same fiscal year. *Id.* The City
2 was thus insolvent. *See infra* Section III(B)(1).

3 Rather than seriously contest the City's cash insolvency, Assured premises its objection
4 on the novel proposition that "before a city can demonstrate insolvency, city leaders must first
5 behave with the necessary financial discipline." Assured Obj. 8. The unspoken premise is that
6 the arbiter of the "necessary financial discipline" is Assured. Of course, this is not the relevant
7 legal standard. If it were, no municipality could ever obtain bankruptcy protection. Every
8 creditor has its own definition of "fiscal discipline." One man's fiscal discipline is another's
9 unfair labor practice, breach of contract, or failure adequately to maintain public safety.

10 If Assured's formulation were the law, any creditor would be able to block a chapter 9
11 petition by arguing that, in hindsight, the debtor municipality should have made different political
12 decisions according to that interested creditor's wishes. To financial creditors, "fiscal discipline"
13 might mean that the City Council should require that labor take more concessions or that a city
14 with a record-high murder rate should lay off another 50 police officers or close all of its libraries.
15 Assured certainly thinks so; its Alternative Model inflicts pain on all other constituencies while
16 assuming that the debt service it backstops will be paid in full, conveniently excusing it from ever
17 having to pay bondholders. To a labor union, on the other hand, "fiscal discipline" might require
18 a city first to default on its debt payments. Retirees' understanding of "fiscal discipline"
19 undoubtedly would include full protection of all health and pension benefits, whatever the costs to
20 other creditors.

21 The truth is that virtually every bankrupt city, corporation, or individual has "budgeted
22 itself into insolvency." Every creditor in a bankruptcy case would jump at the opportunity to turn
23 back the clock five years and make choices for the debtor in a way that ultimately would advance
24 the creditor's own interests, to the detriment of other creditors and parties in interest. But using
25 creditors' paid consultants' idiosyncratic vision of how a city should be operated as a gatekeeper
26 for chapter 9 eligibility is radically inconsistent with the fundamental principles of bankruptcy
27 law generally, and chapter 9 specifically. *See In re City of Vallejo, Cal.*, No. 08-26813-A-9, 2008
28 WL 4180008, *24 (Bankr. E.D. Cal. Sept. 5, 2008) ("Concluding that the City was not eligible to

1 file a chapter 9 petition based on its rejection of a [creditor’s restructuring proposal] would, in
 2 effect, accomplish through denying access to the bankruptcy court what the court would be
 3 prohibited from ordering within a chapter 9 bankruptcy case”). The Court should forcefully reject
 4 Assured’s attempt to effectively write chapter 9 out of the Bankruptcy Code by admitting only the
 5 virtuous and the farsighted, while barring those most in need of relief. As Judge McManus wryly
 6 reminded Vallejo’s labor unions when they raised a similar argument: “you are in bankruptcy
 7 court. It may surprise you to learn people made bad choices before they got here.” Hile Reply
 8 Decl., Ex. E, p. 192:10-14.

9 1. **The City Was Unable to Pay Its Bills as They Became Due in Fiscal**
 10 **Year 2012-13.**

11 In her declaration filed on July 3, Vanessa Burke, now the City’s CFO, projected that the
 12 City held approximately \$1.3 million of available General Fund cash at the June 30, 2012 fiscal
 13 year-end. Burke Decl., ¶ 12. That the City was in a positive cash position at all was due solely to
 14 the City Council’s decision on February 28, 2012 to default on certain debt payments and delay
 15 disbursement of leave payments owed to separating employees, among other measures. Montes
 16 Decl., ¶¶ 35-41.

17 Having now closed the month of June 2012, the City knows that it had approximately
 18 \$1.55, not \$1.3, million in cash on hand, \$250,000 higher than projected, but not nearly enough to
 19 alter the insolvency analysis. Burke Reply Decl., ¶¶ 3-4. With over \$6 million in known cash
 20 obligations in July, over \$4 million of which constituted the first payroll of the fiscal year, the
 21 City lacked sufficient cash to sustain its operations through the month of July 2012. Burke Decl.,
 22 ¶ 14; Burke Reply Decl., ¶ 4. The City also attached to Burke’s declaration a detailed cash flow
 23 analysis which demonstrated that the General Fund would have had a negative cash ending
 24 balance in every month of fiscal year 2012-13, including up to a \$34 million negative ending
 25 balance in November 2012. Burke Decl., ¶¶ 12, 15 & Ex. C; Burke Reply Decl., ¶ 4.

26 Other than relying on the infeasible Alternative Model, none of the Objectors’ experts
 27 materially disputes the soundness of City’s cash solvency analysis. Burke Reply Decl., ¶¶ 4-10.
 28 Rather, Zielke admits that she was unable “to determine whether [the City] was cash flow

1 insolvent on or prior to June 30, 2012.” Zielke Decl., Ex. B, p. 22. Perhaps most critically,
 2 Assured’s experts did not prepare an alternative cash projection, despite their having hired a
 3 former City Finance Officer. Hile Reply Decl., Ex. D, pp. 116:21-117:5 (Zielke “did not do a full
 4 cash flow projection” for the General Fund), 118:23-25 (same), 138:4-17 (indicating that Alvarez
 5 & Marsal hired former City Finance Officer Kathleen VonAchen “to provide us an overview” of
 6 City funds); Hile Reply Decl., Ex. A, p. 116:9-17 (Bobb conducted no analysis of Burke’s cash
 7 flow projection).

8 The closest Assured comes to disputing the City’s cash insolvency is when Zielke
 9 misreads the City’s 2011-12 year-end end results to suggest that the City had a \$5.6 million cash
 10 “surplus” available to it on July 1, 2012. Assured Obj. 26 (the “additional \$6.2 million . . . should
 11 be treated as what they are – a cash surplus demonstrating that the City was not insolvent on the
 12 Petition Date”). First, the Objectors and their purported experts⁶ misunderstand the City’s
 13 accounting methods. As the City made clear in a December 2012 staff report, the \$5.6 million
 14 positive fund balance on June 30 was not available, unrestricted cash to which the City had access
 15 on July 1, 2012, to meet its payroll obligations. Burke Reply Decl., ¶¶ 12-14 & Ex. B. Rather,
 16 these fund balances represented revenues and expenses that the City accrued before July 1 but
 17 which it did not realize as cash until much later. *Id.* Thus, for example, the City’s 2011-12 sales
 18 tax collections turned out to be \$1.1 million higher than expected—a pleasant surprise. *Id.* ¶ 15.
 19 But as of July 1, 2012, the City neither knew this or had access to the additional \$1.1 million in
 20 cash. *Id.* Only in September did the City actually receive the extra money, much later than it
 21 would have needed it to stave off cash insolvency. *Id.* Second, even assuming that the Objectors
 22 are correct that the City had such a cash surplus (which they decidedly are not), replacing “\$1.55
 23 million” with “\$7.15 million [1.55 plus 5.6]” might have scraped the City through July on a cash
 24 basis, but the City certainly would again have run out of cash in August 2012. See Burke Decl.,
 25 Ex. C.

26
 27
 28 ⁶ Significantly, neither Zielke nor Bobb is a CPA, Hile Reply Decl., Ex. A, p. 31:18-20, Hile Reply Decl., Ex. D, p. 24:10-12, and neither has acted as a city’s CFO. Bobb Decl., Ex. B, p. 4; Zielke Decl., Ex. B, pp. 7-9.

1 *Bridgeport* supports the City. See *In re City of Bridgeport*, 129 B.R. 332 (Bankr. D.
2 Conn. 1991). There, the court concluded that the city was not insolvent despite having a \$16
3 million dollar budget deficit for fiscal year 1991-92. The difference between Bridgeport and
4 Stockton is that Bridgeport had \$28 million in unrestricted cash reserves ready and available to
5 cover its \$16 million budget deficit for the fiscal year. See *Bridgeport*, 129 B.R. at 337. The
6 court explained:

7 On July 1, 1991, the first day of the 1991-92 fiscal year, Bridgeport
8 had \$27,908,513.00 in cash. [. . .] Bridgeport intends to use the
9 \$27,908,513.00 to fund its fiscal year operating deficits. The City’s
10 cash flow analysis, which I find persuasive, projects that by using
11 those funds, it will have a positive cash balance in every month of
the 1991-92 fiscal year and \$12,547,699.00 on June 30, 1992, the
last day of that year. [. . .] It is therefore apparent that Bridgeport
will be able to pay its debts as they become due during this 1991-92
fiscal year.

12 *Id.* (citations omitted).

13 Stockton has no reserves in its General Fund. Burke Decl., ¶¶ 10-11. Having already
14 “swept” available cash from other funds, the City also has no money that is available to the
15 General Fund from such other City funds, which neither Bobb nor Zielke dispute. Hile Reply
16 Decl., Ex. D, p. 86:9-17 (Zielke not disputing the accuracy of Burke Decl., Ex. N, listing the
17 sources of restrictions on City’s restricted funds); Zielke Decl., Ex. B, p. 47. The record proves
18 that, absent this bankruptcy case, the General Fund would have experienced a negative cash flow
19 in every month of the 2012-13 fiscal year, ranging as high as negative \$34 million. Burke Decl.,
20 ¶ 15; Burke Reply Decl., ¶¶ 3-4. *Bridgeport* establishes that insolvency is determined on a cash
21 flow analysis; because that municipality had \$28 million in cash to cover the projected \$16
22 million shortfall, the court correctly concluded that Bridgeport was not insolvent.

23 Discussion of the *Vallejo* cases is conspicuously absent from Assured’s brief, perhaps
24 because they are directly on point. By early 2008, the City of Vallejo was grappling with “prior
25 years of operating deficits” and “the program cuts and deferrals those deficits ha[d] necessitated.”
26 *In re City of Vallejo, Cal.*, No. 08-26813-A-9, 2008 WL 4180008, *3 (Bankr. E.D. Cal. Sept. 5,
27 2008). “The City ha[d] reduced expenditures to the point that municipal services ha[d] been
28 decreased and [were] underfunded.” *Id.* *4. Specifically, among other things, the City had

1 reduced General Fund staffing and cut funding for community services, street maintenance, and
2 vehicle replacement. *Id.* In the judgment of the City, additional funding reductions threatened
3 the City's "ability to provide minimal levels of services to its residents and provide for their basic
4 health and safety." *Id.* *5.

5 Vallejo's reserves were exhausted, and projecting a "realistic balanced" budget for the
6 next fiscal year was "exceedingly difficult and unlikely." *Id.* *3. The City's "special purpose or
7 enterprise funds had no significant and legally available money that could be used to cover
8 operating expenses in the General Fund." *Id.* *6. In February 2008, the City negotiated with its
9 employee groups to obtain concessions sufficient to keep the City solvent for a few more months.
10 *Id.* *10. But as the fiscal year drew to a close, the City projected that the General Fund would not
11 have "enough money on hand to cover the" first payroll of the next fiscal year. *Id.* *3. Shortly
12 thereafter, the City filed its chapter 9 petition.

13 Judge McManus found the City of Vallejo insolvent, based on: (1) the City having no
14 reserves; (2) a multi-million dollar deficit; and (3) a demonstration that, absent the bankruptcy
15 case, the City's "General Fund would not have been able to pay its debts as they became due, and
16 in particular, the City would not have been able to pay the General Fund payroll that became due
17 on July 11, 2008." *Id.* *22.

18 On appeal, Judges Jury, Markell and Montali (the "BAP") affirmed Judge McManus'
19 insolvency ruling. *See Int'l Ass'n of Firefighters, Local 1186, v. City of Vallejo (In re City of*
20 *Vallejo)*, 408 B.R. 280 (B.A.P. 9th Cir. 2009). The BAP noted the General Fund's "multimillion
21 deficits in the prior three fiscal years" and the projected \$10 million deficit for the upcoming
22 2008-09 fiscal year, *id.* at 286, as well as Vallejo's inability to make its first payroll of the first
23 fiscal year, *id.* at 288. Critically, the BAP held that, in order to satisfy the requirements of §
24 109(c)(3), a municipality need not cut every possible service: "Vallejo could have cut more
25 services, but the court found that it had reduced expenditures to the point that municipal services
26 were underfunded. More importantly, the court found further funding reductions would threaten
27 Vallejo's ability to provide for the basic health and safety of its citizens." *Id.* at 294.

28

1 The *Vallejo* opinions foreclose Assured's insolvency challenge. Like Vallejo, Stockton
2 exhausted all reserves and has been grappling with multimillion dollar deficits each of the last
3 three fiscal years. Burke Decl., ¶ 10-11; Montes Decl., ¶ 3. Like Vallejo, Stockton was poised to
4 run out of money in the first month of the upcoming fiscal year and would not have been able to
5 pay the first General Fund payroll of that year. Burke Decl., ¶ 14; Burke Reply Decl., ¶ 4. And
6 like Vallejo, it was "exceedingly difficult and unlikely" that Stockton would have been able to
7 produce a "realistic" balanced budget for fiscal year 2012-13 when its municipal services were
8 under-funded and, in the opinion of its City Council, staff, and outside experts, "additional
9 funding reductions threatened the City's ability to provide minimal levels of services to its
10 residents and provide for their basic health and safety." *See supra* Section II(A).

11 Assured rages against the City Council's decision not to eliminate *all* of the City's
12 libraries, parks, and recreation programs. Assured Obj. 9-10 (arguing that programs like "library
13 services"—a "patently non-essential" expense in Assured's eyes—"must be cut" because they are
14 "no longer affordable"). Presumably, in Assured's world a city is not insolvent until it has closed
15 every library, every senior center, every park, every recreation program, and every theater.
16 Assured does not mention, of course, the evidence of how seriously under-funded community
17 services already were in Stockton when the AB 506 process began: the understaffed police
18 department dealing with an escalating violent crime rate, the fire department that sent mechanics
19 with its engines, the untrimmed trees and unrepaired roads, the vehicles beyond their useful lives,
20 or the severe cuts to libraries and other programs that Assured would have eliminated completely.
21 *See supra* Section II. Nor does Assured analyze what might happen if the City closed every
22 recreational and every after-school program, even though its own expert recognizes that these
23 services are important in preventing youth crime. Hile Reply Decl., Ex. A, pp. 139:25-140:11
24 (Bobb describing "a direct correlation" between recreation services and crime), 142:4-11
25 (describing after-school programs as "a contributor for crime reduction"). As its coup de grace,
26 Assured then assumes that after the elimination of virtually every community service, Stockton
27 residents would flock to the polls to support four simultaneous tax increases in order to pay
28 Assured and other creditors in full. Zielke Decl., Ex. B, p. 47.

1 *Vallejo* is both correct and clear. A city need not eliminate every non-police service to
 2 qualify as insolvent, even when these services include a skeletal level of “amenities.” Robert
 3 Bobb asks, “[I]s Stockton in the amenities business?” Bobb Decl., Ex. B, p. 30. To some extent,
 4 every city is in the amenities business, as Bobb and Zielke know well. Hile Reply Decl., Ex. A,
 5 p. 140:12-21 (“all of those services [community policing, recreational programs and library
 6 services] are important to having a viable city and a viable community”); Hile Reply Decl., Ex.
 7 D, p. 93:1-3 (“In [Zielke’s] view, providing for health and safety and quality of life are important
 8 to local governments.”). And it’s telling that neither Bobb nor Zielke cites an example of a single
 9 city that has eliminated every “amenity” and yet remained viable. Indeed, none of the examples
 10 they cite appear to have implemented remotely the level of reductions they propose for Stockton.⁷
 11 Like Vallejo, Stockton’s municipal services are under-staffed relative to other cities, and further
 12 reductions would threaten its ability to provide for the basic health and safety of its citizens.⁸

13 2. *In re Westlake Is Easily Distinguishable.*

14 With *Vallejo* and *Bridgeport* legally and factually supporting the City’s cash flow
 15 analysis, Assured is left clinging for support to *In re Town of Westlake*, 211 B. R. 860 (Bankr.
 16 N.D. Tex. 1997). That’s unfortunate for Assured, since Stockton’s situation could not be more
 17 unlike Westlake’s.

18 Assured reads one snippet from *Westlake* as creating a “budget insolvency” test rather
 19 than the cash insolvency test found in the Bankruptcy Code itself, in *Vallejo*, in *Bridgeport*, and
 20 in all other chapter 9 cases to have considered the issue. *See, e.g., In re Pierce Cnty. Hous. Auth.*,
 21 414 B.R. 702, 711 (Bankr. W.D. Wash. 2009) (“This is a cash flow, not a budget deficit,

22 ⁷ Without any sense of irony, Zielke describes in one breath how “poignant” it was for San Jose to “limit the number
 23 of hours and days [its] libraries are opened,” Zielke Decl., Ex. B, p. 44, and in the next excoriates Stockton for not
 24 closing more libraries. *Id.* p. 59 (“nonessential programs such as the . . . Library Services . . . should be paid from
 either user fees or private donations”).

25 ⁸ Assured’s screed against the use of “comparable cities” in setting wage and compensation levels is undercut by its
 26 own experts, who describe the practice as “a common practice” (Joseph Brann) and “a standard part of negotiations”
 27 (Robert Bobb). Hile Reply Decl., Ex. F, pp. 234:11-235:9; Hile Reply Decl., Ex. A, p. 162:4-15; *see also* Goodrich
 28 Reply Decl., ¶ 5. Another of Assured’s Do-As-I-Say-And-Not-As-I-Dos is pension costs. Not only did Bobb
 oversee labor contracts which placed Oakland police in a “very favorable” position relative to comparable
 jurisdictions, Hile Reply Decl., Ex. G, p. 3, but he recommended and implemented Oakland’s transition from its own,
 more affordable pension system to the 3% @50 CalPERS contracts about which he so vociferously complains. Hile
 Reply Decl., Ex. H, pp. 1-2. By contrast, under its current administration, Stockton has substantially reduced its
 labor costs. *See, e.g., Goodrich Reply Decl.*, ¶¶ 5-11.

1 analysis.”); Assured Obj. 9. Thus, the ultimate conclusion of Assured’s experts appears to be that
2 if the City had made the right *budget* decisions six months, a year, three years, or even ten years
3 ago, it might not have “budgeted itself into insolvency” by June 30, 2012.

4 *Westlake* does not stand for the proposition that a municipality that has made poor
5 decisions is not eligible for bankruptcy relief. Instead, it serves only as an example of a solvent
6 but politically toxic city attempting to game the bankruptcy system, and unsurprisingly being
7 thrown out of court. *See In re Town of Westlake*, 211 B. R. 860 (Bankr. N.D. Tex. 1997). In
8 *Westlake*, the town obviously had contrived a budget to render itself insolvent. First, *Westlake*
9 was embroiled in litigation about who controlled its funds. *Id.* at 862-63. Prior to filing its
10 bankruptcy case, the town council deliberately disannexed 90% of the town’s area, which
11 included a business park that contributed approximately 99% of the town’s annual tax revenue.
12 *See id.* The town filed its chapter 9 petition on June 9, 1997, and a motion to dismiss the petition
13 was set for July 11, 1997. *Id.* The day before the motion to dismiss was to be heard—a month
14 *after* the chapter 9 filing, the town hurriedly adopted a purported budget “without following
15 Texas’ required statutory formalities for an adopted budget.” *Id.* at 866. In that budget, the town
16 incredibly (and, obviously, intentionally and in bad faith) inflated its projected expenditures. For
17 example, the town budgeted \$1.4 million for road repairs for the coming fiscal year, despite
18 having budgeted only \$115,000 and having spent only \$18,641 for road repairs during the prior
19 fiscal year. *Id.* In fact, the town’s entire budget for the prior two fiscal years totaled only
20 \$317,607 and \$201,531, respectively. That the court concluded the town’s budget was a sham
21 and that the town was not insolvent is not a surprise.⁹

22 Assured attempts to analogize the City’s projected fiscal year 2012-13 budget to the sham
23 budget of *Westlake*, Texas. To do so, it must ignore: the three years leading up the City
24 Council’s actions on February 28; the housing crisis, the foreclosures, the plummeting revenues,
25 the high unemployment, the crime, and the creaky City finance infrastructure about which
26 Assured so bitterly complains; the Management Partners report, which concluded that the City

27 ⁹ *Westlake* is the chapter 9 equivalent of *Victory Construction* and all the new debtor syndrome cases that followed it.
28 *See In re Victory Constr. Co.*, 9 B.R. 549 (Bankr. C.D. Cal. 1981); *Duvar Apt., Inc. v. FDIC*, 205 B.R. 196 (B.A.P.
9th Cir. 1996).

1 was “service insolvent” and teetering on the brink of cash insolvency; the City Council’s
2 determination that further cuts to City services were unacceptable; the City’s compliance with the
3 AB 506 process and its preparation of the Ask. Finally, it must ignore the City’s proposed May
4 15, 2012 budget itself, which reasonably forecast revenues and expenses based on past trends,
5 past actions, and current realities. *See supra* Section II(B); Burke Decl., ¶ 21 & Ex. D. True, the
6 May 15, 2012 budget did not adopt the infeasible slash-and-burn measures Assured contends the
7 City should have imposed. Unlike Westlake, though, Stockton already was *in extremis*. The facts
8 establish that the City has not intentionally “budgeted itself into insolvency” and Assured’s
9 reliance on *Westlake* is completely misguided.

10 **3. Even Under Assured’s Fallacious Legal Standard, the Zielke and Bobb**
11 **Reports Would Not Have Ensured the City’s Budget Solvency as of the**
12 **Petition Date.**

12 Neither Zielke’s report nor Bobb’s report contravenes the City’s showing that it was
13 poised to run out of cash shortly after the June 28 petition date. Nor do they contravene the City
14 Council’s determination that, after three years and \$90 million of cuts, it could cut no more
15 without harming the health, safety, and welfare of the community.

16 Instead, the centerpiece of the Zielke report is the Alternative Model. The goal of the
17 Alternative Model is to close the City’s best-case \$25-26 million gap between revenues and
18 expenditures for fiscal year 2012-13. In other words, Zielke places herself in the place of the City
19 Council in early 2012. According to her, had the Council adopted the “\$24 million in cost-cutting
20 measures” and “\$9.5 million in combined revenue-generating activities” identified in the
21 Alternative Model, Zielke Decl., Ex. B, p. 16, the City could have had a balanced budget on July
22 1, 2012.

23 The first problem with the Alternative Model is that it does not include a cash flow
24 projection demonstrating that, even with a balanced budget, the City would have had enough cash
25 in the short term to survive the first few months of the year. The only evidence before the Court
26 of the City’s cash solvency is that presented by Burke, now the City’s CFO. *See* Burke Decl., Ex.
27 C; Burke Reply Decl., ¶¶ 3-4.

28

1 The deeper problem, though, is that upon even cursory examination, the Alternative
 2 Model fails to close the \$26 million to \$38 million gap the City faced for fiscal year 2012-13.
 3 Montes Decl., ¶ 41.

4 The Alternative Model’s proposals just don’t add up. For instance:

- 5 - Its largest revenue component depends on a sales tax increase that the City’s polling
 6 suggested would have achieved 21% support from the voters—hardly a ringing
 7 endorsement from those polled, and not a sound basis on which to budget for millions
 8 of new revenue.
- 9 - The Alternative Model’s \$9 million of “department reductions” represents Zielke’s
 10 arrogation of political authority she did not have to make choices the City Council
 11 chose not to make. As explained above, the Court cannot find the City solvent
 12 because the City Council decided not to impose an additional across-the-board 15%
 13 cut on the City’s organization and its residents.
- 14 - The Alternative Model’s \$11 million in labor reductions assumes that what legal
 15 flexibility the City enjoys *inside* of chapter 9 also was available to it *outside* of chapter
 16 9, which was not true. Had the City been able to impair contracts and otherwise
 17 exercise bankruptcy powers outside of bankruptcy, it would have done so; but it could
 18 not, which is why the chapter 9 petition was necessary.

19 Taken together, these flaws leave the Alternative Model with a huge budget deficit on July
 20 1, 2012, not too much larger than the one City originally projected. The Model cannot serve as a
 21 cognizable basis for refuting the City’s budget or cash flow projection.

22 **a. The Alternative Model Is Fundamentally Flawed.**

23 Bobb claims that the Alternative Model is “realistic, feasible, and appropriate.” Bobb
 24 Decl., Ex. B, p. 11. Significantly, however, he neglects to support his description with any
 25 analysis. The Achilles heel of the Alternative Model is its failure to assess the feasibility of any
 26 of its constituent elements. *See, e.g.*, Hile Reply Decl., Ex. A, pp. 202:22-203:3 (Bobb and Zielke
 27 “did not do any feasibility analysis” of the tax measures in Zielke’s Alternative Model); Hile
 28 Reply Decl., Ex. D, p. 196:15-19 (Zielke “didn’t do any analysis to determine whether or not [the

1 parcel tax] would pass”). It blithely assumes that every option was 100% feasible and that the
 2 City had the resources not only to study but also to implement every option between early 2012
 3 and July 1, 2012. Such an assumption is never true in the real world, and certainly is not true in a
 4 distressed city.

5 The City acknowledges that Zielke’s report contains some laudable concepts. But
 6 concepts, standing alone, mean little if not also analyzed for feasibility: the timing it would take
 7 to implement the ideas, the resources required to implement them, and the risks inherent in
 8 implementing them. What Management Partners realized but Bobb and Zielke do not is that
 9 while the City always should be exploring alternatives to increase its revenues and lower its
 10 expenditures, the City had limited resources as of February 28, 2012 with respect to both. *See*
 11 Montes Decl., Ex. P, p. 9; Ex. Q, p. 251.34. The City allocated those limited resources to
 12 preserving its cash solvency, not because improving fee collections or raising taxes were bad
 13 ideas in the long run, but because preserving cash solvency was a higher priority with the end of
 14 the fiscal year looming. *Id.* Bobb and Zielke’s failure to account for the City’s need to prioritize
 15 limited resources is a defect that undermines the entire Alternative Model.¹⁰

16 **b. The Alternative Model’s Proposed Revenue Increases Were**
 17 **Infeasible.**

18 The Alternative Model’s failure to account for constraints appears perhaps most obviously
 19 in its revenue projections. It assumes that the City would have been able to raise \$9.6 million
 20 within fiscal year 2012-13, \$8.3 million of which the City would derive from tax measures.
 21 Zielke Decl., Ex. B, p. 56. According to the Alternative Model, the City’s residents would have
 22 supported four new tax measures in the November 2012 election: a sales tax, a utility user tax, a
 23 transient occupancy tax, and a parcel tax. *Id.* In incorporating this figure into its Alternative
 24

25 ¹⁰ Despite Bobb’s bravado about sweeping away the “standard bureaucratic reasons for not taking action,” Bobb
 26 Decl., Ex. B, p. 35, he knows well that constraints can limit a public agency’s ability to accomplish its desired goals.
 27 *See* Hile Reply Decl., Ex. I, p. 1 (Oakland voters rejecting a combination of “hotel, parking and utility taxes” that
 28 Bobb helped place on Oakland’s November 2002 ballot to raise money for 100 new police officers); Hile Reply
 Decl., Ex. J, p. 3 (“[L]ibrary supporters celebrated when the [Oakland City] council turned down Bobb’s
 recommendation in February [2003] to cut \$2.1 million from the libraries”); Hile Reply Decl., Ex. K, p. 1 (in May
 2003 Oakland proposed budget, “[L]ibraries and recreation centers, floated for possible closure in an earlier worst-
 case budget scenario, escaped relatively unscathed”).

1 Model, Assured relied on passage rates of similar taxes in the November 2012 election and results
2 from the City's own September 2012 survey, in which Assured claims that "64% of the voters
3 agreed that they would vote in favor of a half-cent sales tax measure." *Id.* p. 49.

4 Assured and Zielke misinterpret the City's tax measure survey results. Survey question
5 #7, to which Zielke cites and which 64% of potential voters positively responded, asked voters if
6 they would support a half-cent sales tax if the proceeds would be devoted to "expanding the
7 police force," "increasing anti-gang and crime prevention programs," and "improving and
8 maintaining street repair, libraries, and parks." Deis Reply Decl., Ex. B, pp. 4-5. In other words,
9 64% of voters would approve a tax increase devoted to increasing these particular services. The
10 Alternative Model, however, increases no such services and decreases other services, so this
11 survey question bears no relation to the Alternative Model.

12 Far more relevant to the truth of the issue is Question 21 in the same survey, a question
13 which Zielke and Assured ignore. Question 21 asked voters if they would approve a tax measure
14 that would

15 primarily provide funding to [a] pay existing debt holders; [b]
16 employee compensation and benefits, and [c] city paid retiree
17 medical benefits, but would not provide funding to improve
existing City services or restore services that have been previously
cut.

18 Deis Reply Decl., Ex. B, p. 15. The Alternative Model precisely calls for the City to pay
19 [a] existing debt holders, Zielke Decl., Ex. B, p. 66; Hile Reply Decl., Ex. D, p. 188:13-17
20 (bondholders are paid "every dime that they assert they have coming to them"); [b] employee
21 compensation and benefits, Zielke Decl., Ex. B, p. 62, and [c] City-paid retiree medical benefits
22 at a 75% benefit level, *id.*, but does not provide funding to improve existing City services or
23 restore services that have been previously cut, Hile Reply Decl., Ex. D, pp. 187:22-188:3
24 (Alternative Model "does not have anything in it which would increase or restore services that
25 had previously been cut"). The voters' responses to Question 21, then, are more relevant to
26 determining the feasibility of the Model's tax measures than their responses to Question 7.

27 In response to Question 21, only 21% of the voters surveyed indicated that they would
28 support a tax increase allocated according to the method outlined there and in the Alternative

1 Model. Deis Reply Decl., Ex. B, p. 15. And the Model calls not for just one tax with a 21%
2 likelihood of passing, but *three additional* tax measures on the same ballot. Zielke Decl., Ex. B,
3 p. 56.

4 This 21% support is not surprising. The Government Finance Officers Association
5 (“GFOA”), on which Zielke so heavily relies, recognizes that citizens of a distressed city (or
6 state) are understandably skeptical about their leaders’ ability to spend wisely any new revenues.
7 GFOA cautions that a “broad tax increase,” like the one Zielke assumes will pass in her
8 Alternative Model, “should be used with extreme caution” because “a distressed government
9 likely has not earned the trust of its citizens.” Hile Reply Decl., Ex. L. Prior service cuts also
10 affect such a measure’s chances because “reduced public value lowers citizen opinion of
11 government, making it less likely they will support new taxes and fees.” *Id.* p. 2. This is exactly
12 what occurred in Stockton. And this is why Management Partners, experienced City staff, and
13 the City Council, while recognizing the long term need for additional revenue sources, also
14 realized that tax measures placed on the November 2012 ballot were likely to fail. Instead, the
15 City Manager and the Mayor suggested waiting until the City had “its house in order” before it
16 asked the voters to “support a restructured, sustainable organization.” Montes Decl., Ex. Q, p.
17 251.26.

18 If the linchpin of the Alternative Model is a sales tax measure with a 21% chance of
19 passing, its other revenue proposals are equally infeasible. Zielke conducted no analysis of
20 whether voters were likely to support her proposed increases in the utility user tax and the
21 transient occupancy tax, or a new parcel tax. Hile Reply Decl., Ex. C, pp. 174:9-17, 196:15-19.
22 Given the voters’ hostility to the sales tax increase the Alternative Model envisions, they likely
23 would not. Zielke also did not account for Stockton’s unique circumstances and whether it made
24 sense to ask voters whose houses already “underwater” or foreclosed to tax their homes further.
25 Nor did she analyze how many cities considered but elected not to place taxes on the ballot. Hile
26 Reply Decl., Ex. C, p. 176:4-8. The Alternative Model also selectively cites only positive results
27 in the most recent election, while ignoring unfavorable data. For example, Zielke suggests that
28 the parcel tax would be devoted only to library services. Zielke Decl., Ex. B, p. 51. She ignores,

1 however, that although five cities in California placed library parcel taxes on the ballot in the
2 November 2012 election, all five failed. Hile Reply Decl., Ex. M, p. 7.

3 c. **The Alternative Model’s \$8.85 Million In “Department Budget**
4 **Reductions” Reflects Only Assured’s Policy Preference To**
5 **Inflict More Pain On The Community Than The City Council**
6 **Was Willing To Inflict.**

7 The expenditure side of the Alternative Model also falls apart when tested. At its heart is
8 Zielke’s statement that the City can achieve \$24 million in reductions “without [, in Assured’s
9 opinion,] materially impacting necessary services.” Zielke Decl., Ex. B, p. 57. The Model
10 obtains this \$24 million from: (1) “Department Budget Reductions” (\$8.9 million); (2)
11 “Restructuring of Employee Personnel & Benefits” (\$12.0 million); (3) “Revised Contract
12 Payments & Loan Debt” (\$732,000); and (4) “Reduce Reinstated Fiscal Stability Measures” (\$2.9
13 million). *Id.*

14 There is nothing innovative about Assured’s proposed savings of \$8.85 million in
15 “department budget reductions.” Zielke Decl., Ex. B, p. 57. All Assured does is take the
16 proposal in front of the City Council on February 28 and change the outcome. Stepping in the
17 shoes of the City Council, Zielke chooses to cut 15% from all non-safety departments and reduce
18 further the City’s funding of libraries, recreation services, and entertainment venues. *Id.* p. 61.
19 This is not a case of “get[ting] rid of the decades of outmoded thinking, bloated costs, tired
20 policies, and [sweeping] away the bureaucratic inertia that prevents fundamental change.” Bobb
21 Decl., ¶ 6. It’s just a different policy choice, a meat-ax policy choice that neither the self-
22 interested Assured nor even this Court is positioned to make. *See* Section III(B).

23 One example aptly illustrates the cynicism permeating the Alternative Model’s approach.
24 Bobb and Zielke devote much of their reports to criticizing the City’s inadequate financial
25 reporting. Zielke Decl., Ex. B, p. 24 (“It is obvious that Stockton’s financial management
26 structure is in need of major fiscal repair”); Bobb Decl., Ex. B, pp. 23-28. Zielke even identifies
27 an accounting system as “an essential part of local government.” Hile Reply Decl., Ex. D, p.
28 90:14-21. And Bobb, drawing upon his experience as a city manager, advocates for preventative

1 maintenance as a means of mitigating future costs. Hile Reply Decl., Ex. A, p. 228:7-11 (citing
2 the GFOA-recommended practice of “spend[ing] money to save money”).

3 Yet, at the same time, the Alternative Model would reduce by 15% the funding for the
4 City’s Administrative Services department, which includes the City’s finance, budget, and
5 information technology functions. Zielke Decl., Ex. B, p. 61; Burke Reply Decl., ¶ 1. So instead
6 of providing more money to fix the problems with the City’s 21-year-old accounting systems they
7 are so willing to criticize, Zielke and Bobb propose to weaken further these essential functions.
8 This schizophrenic proposal is not that of a rational city manager or a disinterested expert, as
9 Bobb and Zielke claim to be. Rather, it is that of two hired guns supporting a creditor whose goal
10 is to maximize its individual recovery at the expense of all others. It is only a creditor’s
11 consultant, not a city manager, who would cut the “must have” accounting system while retaining
12 the “must have” debt payments, as the Alternative Model prescribes.

13 d. **The Majority Of the Proposed Savings In “Employee Personnel**
14 **& Benefits” Are Not Obtainable Outside Of Chapter 9.**

15 Between the phantom new tax income and the illusory “department budget reductions”
16 that Assured did not have the authority to make, the Alternative Model does not viably close the
17 gap between revenue and expenditures in fiscal 2012-13, let alone solve the City’s cash
18 insolvency problem. Additional flaws in the Alternative Model render it even more defective.
19 Assured budgets for an additional \$12.0 million in savings from “employee personnel benefits”
20 that it implies the City was too stupid or too cowardly to realize. To achieve these savings, the
21 Alternative Model adopts a number of measures that the City could not implement in its May 15
22 (pre-bankruptcy) budget but adopted as part of its “Pendency Plan” within the chapter 9 case, or
23 could have implemented but elected not to as a matter of policy.

24 ***Retiree Medical Benefits.*** The Alternative Model’s proposed treatment of the retiree
25 medical benefits provides another example of the cynical pick-and-choose mentality inherent in
26 Assured’s approach. Zielke Decl., Ex. B, p. 64. On the one hand, despite Assured’s bold front,
27 Assured Obj. 33, in early 2012 it was not clearly established as a legal matter that the City could
28 unilaterally impair retiree medical benefits outside of chapter 9. At the very least, the City would

1 have been sued. Two unrelated cases, both of which involve unilateral impairment of retiree
2 medical benefits, are currently pending before the Ninth Circuit; presumably their opinions will
3 help clarify under what circumstances, if any, a city may reduce such benefits. *See Retired Emps.*
4 *Ass'n of Orange Cnty., Inc. v. County of Orange*, No. 12-56706 (9th Cir. Sept. 6, 2012); *Sonoma*
5 *Cnty. Ass'n of Retired Emps. v. Sonoma Cnty.*, No. 10-17873 (9th Cir. Dec. 22, 2010). The
6 *Sonoma* case involves unilateral impairments that then-County Administrator Robert Deis
7 implemented in Sonoma County, so City staff is well versed in the possibilities and risks this
8 option entails. *See Sonoma Cnty. Ass'n of Retired Emps. v. Sonoma Cnty.*, No. 09-4432 (N.D.
9 Cal. Sept. 22, 2009). With the legal issues genuinely unsettled and potential liability for such an
10 impairment running into the hundreds of millions, reducing retiree medical benefits represented a
11 risk the City could not realistically take. Deis Reply Decl., ¶ 26. Significantly, though, once the
12 City obtained the protection afforded by the Bankruptcy Code, it promptly phased out a \$417
13 million unfunded liability despite the very real pain it would cause to many former and current
14 City employees. *See In re City of Stockton, Cal.*, 478 B.R. 8 (Bankr. E.D. Cal. 2012).

15 On the other hand, although the Alternative Model assumes that the City could have
16 impaired retiree medical benefits under state law, it illogically elects to maintain 75% of the
17 benefit (and three-fourths of its \$417 million unfunded liability) rather than scrap it altogether.
18 Retiree medical coverage, unlike a CalPERS pension, is not an industry standard benefit. Haase
19 Decl., ¶ 4 & Ex. A. Nor do retirees provide any current service to the City or its residents. And
20 perhaps most frightening of all, the City has been perpetually *underfunding* its pay-as-you-go
21 obligation. Haase Decl., ¶ 6. So if Zielke were serious about retaining the retiree medical benefit
22 at “75%,” her model should fund it not at \$6.9 million (roughly 75% of the City’s budgeted cost),
23 but at twice that amount.

24 Why retaining the retiree medical benefit in the Alternative Model is so egregious is that
25 once she staked out the position that impairing retiree benefits outside of bankruptcy would not
26 have violated state law, Zielke had no choice but to admit that retiree medical care would have
27 been a “nice to have” for the City, not a “must have.” Hile Reply Decl., Ex. D, pp. 216:18-217:7
28 (calling retiree medical benefits as “a non-essential cost”). She is saying, then, that the City

1 should have retained a \$7 (or even \$14) million “nice to have” that delivered no service value
 2 while at the same time cutting “must haves” like the Administrative Service department
 3 (\$573,311) and needed fiscal stabilization measures (\$2.9 million), to say nothing of the \$1.1
 4 million she would strip from the underfunded Public Works department or the \$3.8 from the
 5 residents’ libraries and recreation program (with their unquestioned effects on reducing crime).
 6 Like many items in the Alternative Model, this proposal has no rational basis.

7 ***Vacancy Savings.*** Zielke purports to capture an additional \$3.5 million by eliminating
 8 vacant public safety positions. The City has documented its difficulties in retaining an adequate
 9 number of qualified police officers. Jones Decl., ¶ 6; Reply Declaration of Eric Jones (“Jones
 10 Reply Decl.”), ¶¶ 7-9. The effect of the Zielke proposal would be throw in the towel in this
 11 struggle, and simply accept that the City will never be able to recruit and retain a sufficient
 12 number of police officers. This is a policy decision that Zielke cannot make for the City, even if
 13 she were qualified to have an opinion about police staffing.

14 ***Pension Hardship.*** The Alternative Model depends on \$1.2 million in savings from a
 15 pension hardship extension, but the California Public Employees’ Retirement System
 16 (“CalPERS”) has denied the City’s request for such a restructuring of pension payments, resulting
 17 in zero savings. Reply Declaration of Teresia Haase (“Haase Reply Decl.”), ¶¶ 2-3.

18 ***Pendency Plan Labor Agreement Changes.*** While the City ultimately may have been
 19 able to bargain or impose some of the Alternative Model’s changes through labor negotiations, it
 20 certainly could not have budgeted the same level of savings as Zielke did in fiscal year 2012-13.
 21 Being subject to state law bargaining procedures outside of chapter 9 (and without a Pendency
 22 Plan to impose changes), the City would not have had new agreements in place by July 1. It is
 23 speculative how much savings it might have captured from the items Zielke identifies, but it
 24 would have been at most only for a partial year.

25 e. **The Elimination Of Fiscal Stability Measures Exemplifies The**
 26 **Alternative Model’s Reckless Disregard For Best Practices.**

27 Like the Alternative Model’s proposed 15% cut to the City’s finance, budget, and
 28 information technology functions, its proposed elimination of the budget’s “fiscal stability

1 measures” is flatly inconsistent with GFOA best practices and its own experts’ advice. It also
2 gives lie to Assured’s claim that it “has a significant stake in the stability and future viability of
3 Stockton.” Assured Obj. 28.

4 In its baseline budget, the City included approximately \$2.9 million for maintenance,
5 elimination of furlough hours (to increase “hours available to get work done”) and a small
6 transfer toward funding an unfunded actuarial liability of \$40 million in the City’s Worker’s
7 Compensation Fund. Burke Decl., Ex. D, pp. A-4, A-7. Despite the GFOA describing such
8 measures as “treatment[s] to use with extreme caution,” Hile Reply Decl., Ex. L, p. 2, the City
9 had already slashed non-safety spending, which resulted in deferred maintenance to City vehicles,
10 roads, facilities, and parks. Montes Decl., ¶ 30. As recently as February 28, 2012, it deferred
11 maintenance on additional projects. *Id.* ¶ 37. Its property was undeniably under-maintained, and
12 it believed that adding back some modest amount for maintenance was a vital sustainability
13 measure. Burke Decl., ¶ 49.

14 Assured’s experts recognize the importance of preventative maintenance. Hile Reply
15 Decl., Ex. A, p. 228:7-11 (Bobb noting that one of the GFOA “tests” is that “municipalities
16 should take when they are in distress . . . is spend money to save money”); Hile Reply Decl., Ex.
17 N, p. 2 (GFOA recommending that “preventative investments” are a “best practice” because
18 “[o]ften, the alternative to a preventative investment is more expensive, after-the-fact
19 mitigation”). But they coolly chop this necessary item from the budget, not because it was a bad
20 use of the money, but undoubtedly because they had to meet a targeted amount in order to prove
21 Assured’s case. Like the 15% cuts to the City’s information technology and budget functions,
22 these are not the steps a rational city manager would propose. *Cf. Vallejo*, 408 B.R. at 293 (“The
23 Unions’ suggestion would leave Vallejo more debilitated tomorrow than it is today.”). That Bobb
24 and Zielke do so undercuts their credibility as any sort of independent or objective experts.

25 * * * * *

26
27
28

1 This summary chart explains how the Alternative Budget Model does not even come close
2 to closing the City's budget gap for fiscal year 2012-13:

3 **Alternative Model FY 12-13 – Feasibility Of Selected Proposals**

4 **Based On Alternative Model's Projected Ending Fund Balance (Hile Decl., Ex. B., p. 47): \$15,075,884**

Proposed Alternative (Page Citation)	Feasibility Of Alternative	Effect on Model
New Revenue Opportunities		
Sales Tax to Pay Debt Service, Retiree Benefits and Existing Employee Compensation and Benefits (p. 27)	City Council believed that tax measures in FY 2012-13 were unlikely to succeed; later polling showed only 21% total voter approval	(\$ 4,686,257)
User Utility Tax, Transient Occupancy Tax, & Parcel Tax (p. 27)	N City Council believed that tax measures in FY 2012-13 were unlikely to succeed	(\$ 3,604,572)
Subtotal-Revenue		(\$ 8,290,829)
Spending Reduction Alternatives		
15% Across-the-Board Department Budget Reductions (p. 30)	City Council determined services were at the minimum necessary for viable city	(\$ 2,605,686)
Community Services Reductions (Reply p. 30)	City Council determined services were at the minimum necessary for viable city	(\$ 4,218,937)
Program Support for Entertainment Venues & Development Services (p. 30)	City Council determined services were at the minimum necessary for viable city	(\$ 1,225,677)
Retiree Medical Reduction (p.31)	City determined that significant legal exposure outside of bankruptcy did not justify savings	(\$ 2,295,159)
Eliminating Public Safety Vacancies (p. 33)	City determined not to eliminate public safety positions	(\$ 3,543,345)
CalPERS Hardship Extension (p. 33)	Denied subsequently by CalPERS	(\$ 1,247,823)
Pendency Plan Labor Agreement Changes (p. 33)	Potentially partially achievable outside of bankruptcy, but effect on FY 2012-13 budget less than in Alternative Model	<i>unknown</i>
Fiscal Sustainability Measures (p. 33)	Necessary to repair and sustain critical infrastructure and to maintain vital internal services; City Council determined services were at the minimum necessary for viable city	<u>(\$ 2,879,016)</u>
Subtotal-Spending		(\$ 18,015,643)
Total Effect on Alternative Model Ending Balance		(\$ 26,306,472)
Alternative Model Ending Balance		<u>\$ 15,076,884</u>
Alternative Model Ending Balance, Accounting For Some, But Not All, Constraints		(\$ 11,229,558)

25
26 *Vallejo* again is analogous. The unions there, like Assured here, hired an expert to create
27 an “alternative budget” that—naturally—guaranteed the City's solvency with a few easy steps.
28 Like Zielke and Bobb, the expert was retained “to analyze the City's 2008-09 budget and its

1 underlying assumptions and projections.” *Vallejo*, 2008 WL 4180008, *16. Like Zielke and
2 Bobb (and unlike Burke), the expert was “not a certified public accountant, an accountant, or a
3 financial auditor.” *Id.* Judge McManus was not persuaded: “Neither Mr. Mialocq’s report nor his
4 testimony persuades the court that the City is solvent or will be solvent in 2008-09, has acted in
5 bad faith, or has significantly misstated its 2008-09 likely revenues or expenditures or revenues.”
6 *Id.* The same is true here.

7 **4. The City’s Finances, Once Unreliable, Are Now Reliable.**

8 Perhaps to distract from the weakness of its insolvency case, Assured argues frequently
9 that the City’s financial information “cannot be trusted to demonstrate insolvency.” Assured Obj.
10 4. Assured does not actually dispute the veracity of any of the numbers on which the City relies
11 to prove its cash insolvency. Rather, it attempts to convince the Court that because the City’s
12 figures once were unreliable, they must be unreliable now.

13 The City has been forthright about errors in its past financial management and accounting
14 practices. Mem. 6; Montes Decl., ¶ 36; Deis Reply Decl., ¶ 30. As City staff observed in its
15 February 28, 2012 report to the City Council, the thorough review that began in 2011 “uncovered
16 substandard bookkeeping, fiscal mismanagement and a general lack of oversight over City-wide
17 finances.” Montes Decl., Ex. Q, p. 251.3.

18 Rather than avoid or conceal these problems, the City proactively worked to remedy them.
19 Staff publicly identified the errors in its past financial management and accounting policies in a
20 series of reports presented to the City Council, and prepared strategies for remedying the
21 deficiencies. Deis Reply Decl., ¶ 30. Faced with limited resources, antiquated infrastructure, and
22 a lack of experienced employees, the City used triage to complete the highest priority repairs first,
23 *id.* ¶¶ 32-33, while still adhering to the GFOA principle that “governments certainly should not
24 sacrifice reliability for timeliness.” Hile Reply Decl., Ex. O, p. 1. While work remains, the City
25 has now fixed many of the problems identified by Assured and its experts. Burke Reply Decl., ¶
26 23; Deis Reply Decl., ¶ 34.

27 It is telling that the most recent evidence upon which Assured relies is a September 2011
28 memorandum prepared by then-CFO Susan Mayer at the request of City Manager Robert Deis.

1 Assured Obj. 21-22. The memorandum exhaustively catalogued the problems that Mayer had
2 uncovered since joining the City in early 2011. Deis Reply Decl., ¶ 30, Burke Reply Decl., ¶ 23.
3 Rather than proving that the City's current financial policies are an "ongoing disaster," Bobb
4 Decl., Ex. B, p. 25, Mayer's memorandum was an important step toward remedying past practices
5 and turning the City's financial data and reporting systems in the right direction. Deis Reply
6 Decl., ¶ 30.

7 Assured also contends that the material weaknesses and significant deficiencies noted in
8 the City's 2010-11 Comprehensive Annual Financial Report ("CAFR") "call the City's current
9 and future results into serious question." Assured Obj. 23. The opposite is true. Assured fails to
10 explain (or perhaps understand) the distinction between (1) the integrity of the actual financial
11 data, which current staff control; and (2) the integrity of the City's controls underlying the data.
12 Burke Reply Decl., ¶¶ 17-21. The material weaknesses and significant deficiencies identified in
13 the 2010-11 CAFR, *see* Burke Reply Decl., Ex. C, pp. 647-676, relate to the controls in the City's
14 financial reporting system. That is, there were weaknesses and deficiencies in the methods and
15 procedures which the City used to ensure the accuracy of its financial information, many of which
16 predated the current administration. *Id.* ¶ 19. There are no weaknesses or deficiencies in the
17 *information* itself. *Id.* ¶¶ 20-21. So while the City is still working to bring its financial controls
18 up to date, the financial numbers themselves are accurate and were accurate as the City was
19 preparing its chapter 9 petition. *Id.*

20 The City's outside auditors confirmed this by issuing an "unqualified" audit opinion of the
21 City's financial results. Burke Reply Decl., ¶ 21. Specifically, they found that "[n]othing came
22 to our attention that caused us to believe that such information [in the audit report], or its manner
23 of presentation, is materially inconsistent with the information, or manner of its presentation,
24 appearing in the financial statements." *Id.* Ex. C, pp. 683-686. The City's auditors also did not
25 feel it necessary to "propose any audit adjustments that, in our judgment, could have a significant
26 effect either individually or in the aggregate, on the entity's financial reporting process." *Id.* Ex
27 C., p. 686. In other words, the City received a clean bill of health for the financial information it
28 used as the basis for its Ask and chapter 9 preparations. Burke Reply Decl., ¶¶ 20-21.

1 Assured also attacks the City for the variances between its budgeted numbers and its
2 actual results, claiming that the 1-3% budget-to-actual variances reported in the City's December
3 11, 2012 budget update "[c]ast[] still more doubt on the City's understanding of its finances,"
4 "impeach the City's credibility," and "undermine the City's case that it was 'insolvent' on the
5 Petition Date." Assured Obj. 25. However, Assured's own expert confirmed that "there's
6 nothing wrong with a budget ending up not being exactly what the actual results are." Hile Reply
7 Decl., Ex. D, p. 110:18-21. In fact, Zielke, when confronted with the budget-to-actual variances
8 in the Detroit Public Schools budget during her tenure as budget consultant there, admitted that
9 she didn't "see anything that is out of the ordinary" with actual revenues varying from budgeted
10 revenues by more than ten percent. *Id.* pp. 109:21-110:8. It is difficult to understand how the
11 City's budget-to-actual variances of 1 % (revenues) and 3.2 % (expenses) "impeach the City's
12 credibility" when its own expert blessed a budget-to-actual variance of much greater magnitude
13 as nothing "out of the ordinary." Burke Reply Decl., Ex. B, p. 690.

14 **5. No Evidentiary Hearing Is Required to Establish the City's Insolvency.**

15 The foregoing demonstrates why the Alternative Model and the expert reports fail to
16 counter the City's proof that it was insolvent on the petition date. It also demonstrates that
17 Assured's attack on the City's proof of its insolvency fails as well. Unfortunately, the City had
18 no choice but to expend scarce resources in order to respond. But more time and money need not
19 be spent on an evidentiary hearing on the question of insolvency.

20 The case law establishes two grounds on which to find a municipality not insolvent. One
21 is cash solvency; this is *Bridgeport*, whose \$28 million in cash reserves was sufficient to close its
22 \$16 million deficit. The other is out and out fraud committed by an otherwise solvent city; this is
23 *Westlake*. Neither describes Stockton. Assured attempts to create a third insolvency measuring
24 stick: lack of "fiscal discipline," as viewed through the eyes of one creditor. This test is found
25 nowhere in the Bankruptcy Code or in the case law, and is radically inconsistent with basic
26 bankruptcy principles. The Court should repudiate it as a matter of law.

27 Even if the Alternative Model were remotely feasible, this Court cannot deem the City not
28 insolvent for failing to (1) cut another \$9 million from its budget, when the undisputed evidence

1 demonstrates that the City was already at “service insolvency”; or (2) place a tax measure on the
2 next ballot, when the undisputed evidence demonstrates that such a measure was very likely to
3 fail. These are policy decisions entrusted to a municipality’s democratically-elected leaders, not
4 to one creditor or even to a federal judge. *See In re City of Vallejo, Cal.*, No. 08-26813-A-9, 2008
5 WL 4180008, *24 (Bankr. E.D. Cal. Sept. 5, 2008) (“Concluding that the City was not eligible to
6 file a chapter 9 petition based on its rejection of a [creditor’s restructuring proposal] would, in
7 effect, accomplish through denying access to the bankruptcy court what the court would be
8 prohibited from ordering within a chapter 9 bankruptcy case”). Because this “We know how to
9 run Stockton better than you” theory represents the only possible ground on which Assured
10 contests insolvency, the Court should rule as a matter of law that the City is insolvent. It need not
11 hold an evidentiary hearing on the issue.

12 **C. The City Desires To Effect A Plan To Adjust Its Debts (§ 109(c)(4)).**

13 The Objectors do not dispute that the City desired to effect a plan to adjust its debts. *See*
14 *Mem. 37-38*. Nor do they dispute that Stockton’s City Manager certified the City’s desire to
15 effect a plan. *See Statement of Qualifications [Dkt. No. 5]; Vallejo*, 408 B.R. at 295. And the
16 City’s good faith drafting of the Ask, along with its adoption of a Pendency Plan, demonstrates
17 that its petition is “designed to result in an eventual plan of adjustment of debts.” *Vallejo*, 408
18 B.R. at 295 (finding the adoption of a pendency plan indicative of Vallejo’s intent to effect a plan
19 of adjustment).

20 All the Objectors state with respect to this prong is: “Because the City has (i) failed to
21 negotiate with Assured; (ii) chosen not to negotiate with CalPERS; and (iii) refused to consider
22 anything other than a plan that unfairly discriminates and is neither feasible nor fair and equitable,
23 the City also cannot carry its burden of demonstrating a ‘desire to effect a plan to adjust the debts
24 it is . . . unable to pay.’” Assured Prelim. Obj. 18 n. 21. All these arguments go to good faith
25 under subsection (5), not the City’s desire under subsection (4). The Court should disregard them
26 in its analysis of subsection (4) and hold that the City filed the petition with the desire to effect a
27 plan to adjust its debts.

28

1 **D. The City Has Satisfied The Negotiation Requirements (§ 109(c)(5)).**

2 In the Memorandum, the City demonstrated how it satisfied two of the alternative tests
3 under 11 U.S.C. § 109(c)(5). Mem. 38-41. National, which did not dispute the City’s insolvency,
4 joined Assured and Franklin in objecting to the City’s pre-filing good faith. The core of
5 National’s and Assured’s objections, and their only serious quarrel with the City’s good faith, is
6 that the City did not “seek concessions” from CalPERS before filing its chapter 9 petition. In
7 other words, the City should have attempted to reduce its monthly pension payments to current
8 City retirees (most of which money CalPERS holds as a conduit established by statute) and/or
9 somehow reduced its pension obligations to current employees.

10 The first defect in this theory is that “reducing” its pension obligations outside of chapter
11 9 would have exposed the City to massive legal risk, for which the Objectors completely neglect
12 to account. Second, as demonstrated below, the Objectors use CalPERS as a fig leaf to disguise
13 their true argument: the City should have asked more from its retirees and current employees, and
14 that its failure to do so constituted a lack of good faith. This objection is baseless. The City in
15 good faith asked what it thought it could from its employees, whose wages and compensation
16 now have been brought down from pre-recession highs to industry standards. It was not a lack of
17 good faith for the City to risk losing employees—particularly police officers—by reducing their
18 total wages and compensation to below those offered by comparable cities.

19 The Objectors retained two experts, a former police chief and an academic, to dispute the
20 City’s concern that taking away its police officers’ industry standard pensions might prompt some
21 officers to leave the City. The City based its assessment on its historical difficulty recruiting and
22 retaining officers to one of the most dangerous and under-staffed cities in California, to the severe
23 cuts to employee wages and benefits over the last few years, and to the Police Chief’s personal
24 knowledge of his department¹¹ and the reasons why individual officers stayed or left. While
25 dismissing the City’s evidence as “anecdotal,” neither of Assured’s purported labor experts
26 presents a shred of contrary evidence to refute it. All the U.C. Irvine professor suggests is that, in

27 _____
28 ¹¹ As noted in his initial declaration, Chief Jones has served in the Stockton Police Department in some capacity for
over 19 years. Jones Decl., ¶ 2.

1 early 2012, the City should have commissioned a \$500,000, potentially inconclusive six-to-12
2 month study, to determine whether raiding employee pensions *actually* would cause any officers
3 to leave. This, of course, was in a year during which the City would have run out of cash in early
4 July and was grappling with a record number of murders. *See* Jones Reply Decl., ¶ 5; Diana
5 Marcum, *Stockton Council Candidate Never Forgot Where He Came From*, L.A. TIMES, Nov. 4,
6 2012, available at 2012 WLNR 23408357 (“[H]er family slept in the middle of the living room
7 floor, huddled together, because of the neighborhood gunfire. She said the gun smoke sometimes
8 was so thick that it sets off her son’s asthma.”).

9 What fatally undermines these experts’ opinions is that they know nothing about Stockton,
10 its financial condition, its police, or—most importantly—the history of staffing reductions and
11 wage cuts that preceded the chapter 9 filing. All they appear to have analyzed was a hypothetical
12 city that imposed a hypothetical 10% wage cut on its police force. Unsurprisingly, their
13 conclusion was that in a hypothetical city, a 10% cut wouldn’t *necessarily* spark a “mass exodus.”
14 But when confronted in their depositions with actual facts relating to Stockton, they agreed that
15 they would have “serious concerns” about losing officers in the exact situation with which City
16 management was grappling in early 2012. Rather than disprove the City’s concerns, they affirm
17 them.

18 The Objectors want to go back in time, step into the shoes of the City Council, and tell the
19 City’s residents that they should have signed up for a sociological experiment by reducing their
20 police officers’ wages to below market and then, in a violent town, seeing what would happen.
21 The City had ample reasons not to seek further reductions in employee compensation and
22 benefits, not the least of which was that tampering with pensions outside of chapter 9 would have
23 exposed it to massive legal risk and likely would have pushed it into chapter 9 even faster. The
24 City’s conduct, particularly with respect to its police, cannot be seen as other than in good faith
25 because there undoubtedly was *risk* that depriving employees of a CalPERS pension would have
26 sparked an exodus of police officers of the City, even if the City did not conduct a yearlong
27 academic study to determine the exact correlation between pension cuts and number of
28

1 departures. The City could not afford to take this risk, and was not in bad faith by choosing not to
2 do so.

3 **1. The City Negotiated in Good Faith With What Creditors It Could (§**
4 **109(c)(5)(B)).**

5 **a. The City Was Not Required To Have A Confirmable Plan In**
6 **Place To Be Eligible For Chapter 9 Relief.**

7 As an initial matter, National in particular challenges the City's good faith on the grounds
8 that the City, before filing its chapter 9 petition, did not present a feasible plan confirmable under
9 11 U.S.C. § 943. National Prelim. Obj. 10 (Ask "is not a feasible plan or in the best interests of
10 creditors"). Similarly, Assured complains that the City was discussing a "plan that unfairly
11 discriminates and is neither feasible nor fair and equitable." Assured Prelim. Obj. 18 n. 21.

12 This is the language of plan confirmation, not eligibility. The Bankruptcy Code does not
13 require that a municipality filing for chapter 9 also have in hand a plan that is instantly and iron-
14 clad confirmable under § 943. Such a result would be contrary to the purpose of chapter 9, which
15 is to afford the debtor "temporary protection from debt collection efforts *so that it may establish a*
16 *plan of adjustment with its creditors.*" *In re Valley Health Sys.*, 383 B.R. 156, 163 (Bankr. C.D.
17 Cal. 2008) (emphasis added).

18 Thus, in *Vallejo*, the BAP held that a municipality need not have formulated a "complete
19 plan" to be eligible for chapter 9 relief. Instead, all a municipality needed in order to satisfy its
20 obligation to negotiate in good faith was "a proposed plan" "in concept," or "some outline or term
21 sheet of a plan which designates classes of creditors and their treatment." *Vallejo*, 408 B.R. at
22 297.

23 Similarly, in *In re New York City Off-Track Betting Corp.*, 427 B.R. 256 (Bankr. S.D.N.Y.
24 2010) ("*OTB*"), the court addressed the eligibility objectors' theory that "unless a chapter 9 debtor
25 can present, simultaneously with its filing, a comprehensive plan of reorganization, the petition
26 was filed in bad faith." *Id.* at 281. Judge Glenn forcefully rejected this contention: "There simply
27 is no requirement, in the chapter 9 or chapter 11 context, for a debtor to have solved the riddles of
28 its business woes prior to filing for bankruptcy. . . . Indeed, imposing this type of prerequisite
could drastically reduce debtor's access to bankruptcy protection, resulting in the disorderly

1 liquidation of estates.” *Id.* (also characterizing *In re Sullivan County Reg’l Refuse Disposal*, 165
 2 B.R. 60 (Bankr. D.N.H. 1994), as involving a chapter 9 petition “filed merely as a litigation
 3 tactic, with no real thought or sincere intention of debt adjustment in an overall plan sense”)
 4 (internal quotations omitted).

5 The Ask amply satisfied the City’s obligation to prepare an “outline or term sheet of a
 6 plan which,” “in concept,” “designates classes of creditors and their treatment.” 408 B.R. at 297.
 7 In fact, it is exactly that. *See* Millican Decl., Ex. A, pp. 19-21 (“AB 506 Framework for
 8 Proposals to Creditors”), 57-61 (“Summary of AB 506 Proposals”). In the Ask, the City divided
 9 up its major creditor groups by class: labor, retiree medical, debt, and “other.” *Id.* It first
 10 articulated “Principles Specific to [each class],” i.e., its assumptions. *Id.* at p. 20. It then
 11 explained its financial situation and high-level objectives, with the guiding principle being that
 12 the City needed to become solvent and then remain sustainable. *Id.* at pp. 21-22. Finally, the
 13 City translated its assumptions into concrete proposals to each class, *id.* at pp. 24-56, followed by
 14 an overarching summary of the proposals and hundreds of pages of supplementary data and other
 15 material. *Id.* at pp. 57-790.

16 This is exactly the approach that a debtor should take in formulating a plan of adjustment.
 17 The City divided its creditors¹² into classes. Every creditor received notice of how the City
 18 tentatively viewed its claim in a potential financial restructuring, along with the assumptions
 19 underlying the proposed treatment. At the eligibility stage, no more is required.

20 **b. The City’s Participation In The AB 506 Process Satisfied The**
 21 **Requirements Of Section 109(c)(5)**

22 Beyond the plain language of the Ask, the City can easily demonstrate that it “has
 23 negotiated in good faith” with its creditors prepetition. 11 U.S.C. § 109(c)(5)(B). As explained
 24 in the Memorandum, on a parallel course with its staffing reductions, for years the City engaged
 25 in near-constant negotiations with its labor unions, and achieved substantial results. Mem. 39.
 26 When it became obvious that, despite past cuts, the City faced a budget gap for fiscal year 2012-

27 _____
 28 ¹² As explained in Section III(D)(1)(c) below, CalPERS was not a “creditor” in the sense that any concessions could
 be obtained from it through the Ask.

1 13 that it could not close, rather than declare another “fiscal emergency” and bolt into bankruptcy
2 court via the emergency off-ramp of California Government Code section 53760(b), the City
3 elected to enter the AB 506 mediation process, *id.* § 53760(a). There, it expended significant
4 time and resources developing the Ask, providing extensive information, and engaging in dozens
5 of meetings with its nine labor groups, retirees, and financial creditors. These efforts yielded
6 results, as the City ultimately obtained new agreements from all nine of its unions and paved the
7 way for the reduction in bankruptcy of its single largest liability, retiree medical costs. *See supra*
8 Section III(A).

9 Rather than dispute any of this, the Objectors zero in on one sentence in the City’s Ask:
10 “The total savings from the proposed AB 506 proposals is \$25.0 million in FY12-13, and
11 averages \$30.3 annually through FY 20-21. Unfortunately, while the AB 506 proposal savings is
12 absolutely necessary, it alone is not sufficient to close the City’s ongoing budget gap.” Millican
13 Decl., Ex. A, p. 58. From this, they argue that because the combined proposals to each group
14 could not close the “budget gap,” the Ask was a charade and the City never intended to
15 restructure outside of bankruptcy.

16 As *OTB* makes clear, a municipality that has not yet “solved the riddles of its business
17 woes” may still be found to have negotiated with creditors and filed its chapter 9 petition in good
18 faith. 427 B.R. at 281. The Ask assumed, just like the City Council did on February 28, 2012, a
19 certain level of sustainability and service delivery in a city that already was service insolvent.
20 Millican Decl., Ex. A, p. 60. This was a policy decision, not a technical one, that this Court
21 should not, indeed may not, second-guess. From a technical perspective, the Objectors do not
22 seriously quibble with the assumptions and information that the City embedded in the Ask. Their
23 only complaint is that the City could not avoid the necessary constraint of having to deliver a
24 certain level of services to its citizens.

25 That the City could not figure out a method to legally and sustainably close its budget gap
26 did not mean that it was acting in bad faith, particularly when the alternative was to adopt
27 something like Zielke’s seriously flawed Alternative Model. It just meant that the City was very
28 insolvent and had offered what it could afford. The City straightforwardly acknowledged the

1 challenge raised by the Objectors: “[I]t is important to note that additional cost reductions, new
2 revenue, or a combination of both are required to be financially sustainable in the future.”
3 Millican Decl., Ex. A, p. 60. But given the challenges that it faced, the best it could do was
4 promise prepetition that “appropriate budget strategies will be developed in the fiscal year FY12-
5 13 budget and subsequent years remaining after the conclusion of the AB 506 process.” *Id.*

6 Assured and National also argue that the City failed to negotiate in good faith with them
7 pursuant to section 109(c)(5)(B) in part by characterizing the City’s Ask as a “take-it-or-leave-it”
8 offer. Assured Obj. 31-32; National Obj. 5-6 (both citing *In re Ellicott Sch. Bldg. Auth.*, 150 B.R.
9 261, 266 (Bankr. D. Colo. 1992)). *Ellicott* is easily distinguishable from the present case for two
10 reasons. First and foremost, the court in *Ellicott* held that the debtor was not a municipality and
11 thus the remainder of the decision is dicta. 150 B.R. at 264. Moreover, by virtue of the *Ellicott*
12 debtor not being a municipality, it lacked the obligations that a municipality such as Stockton has
13 to maintain the resources necessary to deliver a certain level of services to its citizens. Unlike
14 Stockton, the *Ellicott* debtor was simply a non-profit corporation with the stated purpose to
15 acquire land, construct a school on that land, and lease that land to a school district. *Id.* at 262. It
16 had no citizens to serve. *See Collier on Bankruptcy*, ¶ 943.03[1][f][i][B] (“[A municipality] must
17 still have adequate revenues to continue its operations, because [it] cannot be dismantled or
18 liquidated as in ordinary bankruptcy.”) (citing *Newhouse v. Corcoran Irrigation Dist.*, 114 F.2d
19 690 (9th Cir. 1940).

20 Second, the *Ellicott* court concluded that the debtor was solvent because its evidence “did
21 not conclusively demonstrate that [it was] unable to pay its debts as they [became] due.” 150
22 B.R. at 265. Specifically, the court found (as did the *Bridgeport* court) that the debtor could have
23 used its reserve fund to pay its debt payments and that it failed to prove its inability to collect a
24 defaulted rent payment. *Id.* Unlike the *Ellicott* debtor, Stockton is insolvent; it offered up every
25 penny it could through its Ask; and it exhausted all feasible means to pay its debts and avoid
26 bankruptcy as demonstrated by its Ask and participation in the AB 506 process. *See supra*
27 Sections III(A), III(B). Thus, the City’s position as an insolvent municipality is fundamentally
28

1 different from that of the solvent non-profit in *Ellicott*, and the court's ruling as to good faith has
2 no application here.

3 Finally, it is worth noting that chapter 9 imposes a good faith requirement only on the
4 City. Its creditors have no obligation to participate in good faith, a "nonrequirement" of which
5 the Capital Markets Creditors took full advantage. For example, AB 506 requires that the City
6 pay "50 percent of the costs of the neutral evaluation . . . and the creditors shall pay the balance."
7 Cal. Gov't Code § 53760.3(s). The Capital Markets Creditors refused to pay for their share of the
8 mediation, leaving the City either to shoulder the complete burden or to shove half of it on its
9 unions and retirees. *See, e.g.*, Hile Reply Decl., Ex. P, p. 2, ("National disclaims any obligation
10 or liability for the payment of any costs or expenses under Section 53760.3(s) of the Act."). The
11 City chose to bear the entire burden itself. Similarly, Assured's suggestion that "Stockton refused
12 to negotiate with Assured" is refuted by the evidence, which demonstrates that Assured never
13 provided a counteroffer to the Ask. Levinson Decl., ¶ 5 and Ex. C, p. 2.

14 In sum, that the Objectors did not like the City's offer does not mean that the City did not
15 extend it in good faith. The City's long history of battling its financial troubles and its conduct
16 throughout the AB 506 process sufficiently demonstrated its good faith toward its creditors.

17 c. **The City's Refusal Unilaterally To Reduce Pension Benefits For**
18 **Retirees And Current Employees Did Not Constitute A Lack Of**
19 **Good Faith**

20 "By failing to negotiate at all with CalPERS, the City cannot claim to have negotiated in
21 good faith for purposes of 11 U.S.C. § 109(c)(5)." Assured Obj. 28; *see also* National Obj. 3.
22 This idea is prominently featured in Assured's objection; the same argument also is the crux of
23 National's objection. *See* National Obj. 8 ("[T]he City's decision not to impair CalPERS was the
24 fulcrum of the Ask and the AB 506 process").

25 This talking point is based on a fiction that the Objectors perpetuate in their court filings
26 and public statements. The pot of money which the Objectors contend the City should have
27 opened during the AB 506 process did not belong to CalPERS, which is not a conventional
28 business creditor. Rather, CalPERS is a conduit through which the City (1) prefunds its pension
obligations by setting aside some amount each month for each of its employees; and (2) funds the

1 pensions of retired City employees. Outside of chapter 9, California law bound both CalPERS
2 and the City. Under state law, CalPERS could not dip into retirees' funds and hand that money
3 back to Stockton for distribution to creditors. Nor could the City unilaterally stop making its
4 pension payments, either for already-retired employees (to the extent that their prefunded portion
5 was insufficient) or for current employees.

6 So while CalPERS serves as a convenient strawman for the Objectors, their real argument
7 is that the City's past and current cuts to employees and retirees "do not go nearly far enough."
8 Assured Obj. 2. It was not good faith, the Objectors say, for the City only to bring its employees'
9 salaries and benefits to the median of the market, or to take from retirees only medical insurance
10 and not pensions. Good faith to them means that the City had to ask for much more: to bring its
11 employees far below market wages and salaries and to take *both* medical care and pensions from
12 its retirees. To the Objectors, not asking for or taking more was not good faith. The absurdity of
13 the argument speaks for itself, and the Court should reject it.

14 (1) **Outside of Chapter 9, Neither the City nor CalPERS**
15 **Could Legally Reduce Pension Benefits for the City's**
16 **Retirees and Current Employees**

17 The Objectors constantly hammer the City for not "seeking concessions" or "a reduction"
18 from CalPERS during the AB 506 process. *See, e.g.*, Assured Obj. 26-27; National Obj. 2.
19 Curiously, they omit specifics about what exactly the City should have done or what CalPERS
20 could have given up outside of chapter 9. This vagueness is not surprising because, as the
21 Objectors know, under applicable nonbankruptcy law, neither the City nor CalPERS have the
22 power to loot the funds held by CalPERS on behalf of the City's retirees. There was nothing to
23 "negotiate" with CalPERS, and no "concessions" for CalPERS to make.

24 Under applicable nonbankruptcy law, there is neither legal authority nor precedent for
25 CalPERS to impair members' vested pension benefits. *See Cal. Ass'n of Prof'l Scientists v.*
26 *Schwarzenegger*, 137 Cal. App. 4th 371, 383 (2006) ("[B]oth the federal and state contract
27 clauses protect the vested pension rights of public officers and employees from unreasonable
28 impairment.") (citation omitted). Peter H. Mixon, CalPERS General Counsel since 2002 (who
joined CalPERS in 1996), testified that he does not recall CalPERS ever considering

1 administering a plan containing a bargained-for set of reductions for current employees. Hile
2 Reply Decl., Ex. Q, p. 53:11-18. Nor is he “aware of any specific instances where a particular
3 city proposed reducing benefits to active employees as part of the CalPERS system.” *Id.* pp.
4 55:3-5. There is a good reason why Mixon does not recall either of these events ever happening:
5 pursuant to state law, once a contracting agency makes an election for benefit formulas in its
6 CalPERS contract, the election is irrevocable, and benefits provided under that election for
7 current employees and retirees can only be increased. Cal. Gov’t Code § 20474. Only in the case
8 of new hires, newly classified employees, and certain rehired employees can a contracting agency
9 amend its contract with CalPERS to reduce benefits, terminate provisions, or provide different
10 benefits. Cal. Gov’t Code § 20475. CalPERS must adhere to these rules because it is governed
11 by statute, and cannot waive statutory requirements. *City of Oakland v. Pub. Emps. Retirement*
12 *Sys.*, 95 Cal. App. 4th 29, 39 (2002) (“The PERS Board is governed by the California
13 Constitution and statutes.”); Hile Reply Decl., Ex. Q, pp. 46:17-23; 47:14-49:22. Additionally, a
14 CalPERS contracting agency must adhere to these rules because upon entering into a CalPERS
15 contract, the agency is bound by applicable provisions in the same statutes. Cal Gov’t Code §
16 20506.

17 Assured’s own experts tacitly recognize this. Unsurprisingly, not only had Bobb never
18 “engaged” CalPERS to discuss whether it would reduce the contribution payments due from the
19 California cities that he managed, Hile Reply Decl., Ex. A, p. 46:3-9, he had never even heard of
20 it being done. *Id.* p. 46:10-13. Similarly, Joseph Brann, a former Hayward Chief of Police, who
21 claims that he has experience at the “bargaining table” on behalf of the Santa Ana police union,
22 also is not aware of California police officer pensions ever being impaired. Hile Reply Decl., Ex.
23 F, pp. 104:8-22, 236:21-237:12. Perhaps most tellingly, the Alternative Model, premised on
24 “putting *everything*—and that means *everything*—on the table,” Bobb Decl., Ex. B, p. 32,
25 mysteriously leaves the City’s pension obligations untouched. It’s just another example of
26 Assured’s transparently cynical approach that it would argue that the City acted in bad faith by
27 not unilaterally impairing pensions, while at the same time knowing full well that unilaterally
28 impairing pensions was not possible outside of chapter 9. Assured again would bar the City from

1 bankruptcy court for not doing something that it itself knew to be neither feasible nor legal
2 outside of chapter 9.¹³

3 In its Objection, Assured attempts to preemptively refute this reality: “The City invited
4 CalPERS to attend the AB 506 Process, and CalPERS did not decline. Further, CalPERS’
5 governing statute gives its board broad discretion to work with municipalities, to adjust discount
6 rates, and to stretch repayment horizons.” Assured Obj. 27 n.18. As the statutory scheme and
7 CalPERS itself make clear, “adjust[ing] discount rates” and “stretch[ing] repayment horizons” do
8 not equate to a roving discretion under which CalPERS could suddenly allow the City to raid
9 funds already earmarked for pensioners or could arbitrarily bend the rules to ad hoc reduce the
10 City’s contribution rates.

11 (2) **Termination of Its CalPERS Contract Would**
12 **Immediately Have Plunged the City Deeper Into**
13 **Insolvency**

14 Since “engaging” CalPERS to cough up other people’s money was not a viable option, it
15 is unclear exactly what else the Objectors wanted the City to include in the Ask or in the AB 506
16 meetings to avoid being found in “bad faith.” One option they suggest is that the City simply
17 should have withdrawn from CalPERS (or had its plan terminated for non-payment). Assured
18 Obj. 27-28.

19 This approach too would have been subject to California law, which was fully applicable
20 to the City outside of chapter 9. First, withdrawing from CalPERS would have exposed the City
21 to a massive “termination liability” that it would have had no hope of satisfying outside of chapter
22 9. *See* Cal Gov’t Code § 20574. When an agency terminates its CalPERS plan(s), it remains
23 liable for the amount of pension benefits it has not yet funded (i.e., its unfunded liability). *Id.*
24 When CalPERS calculates the amount of the unfunded liability, it does so not at the current rate
25 of return,¹⁴ but at a risk-free rate of return so as to ensure that the unfunded liability will be fully
26 covered by the terminating agency before it slips out of CalPERS’ control. Hile Reply Decl., Ex.

27 ¹³ Contrary to Assured’s and National’s intimations, the City has reduced its pension obligations where it legally
28 could. Haase Reply Decl., ¶¶ 2-6.

¹⁴ The rate of return as of the Petition Date was 7.5%. Hile Reply Decl., Ex. R, p. STOCK147926 (miscellaneous);
Hile Reply Decl., Ex. S, p. STOCK147989 (safety).

1 T, p. 113:3-24. Unsurprisingly, a liability calculated using a risk-free rate of return is much
2 higher than a liability calculated using a much higher rate of return.

3 CalPERS calculated the City's "termination liability," which would include the deficit in
4 funding for earned benefits, interest, collection costs, and attorney's fees, Cal Gov't Code §
5 20574, to be approximately \$2 billion dollars if the City withdrew in 2011. Hile Reply Decl., Ex.
6 R, p. STOCK147940 (miscellaneous); Hile Reply Decl., Ex. S, p. STOCK148003 (safety). Of
7 this, approximately \$946 million would be completely unfunded (i.e., termination liability less
8 assets in the system). *Id.* CalPERS' Deputy Chief Actuary testified that the City's 2012
9 termination liability would have been even greater than its 2011 liability because of a lower risk-
10 free rate of return in 2012. Hile Reply Decl., Ex. T, pp. 111:21-112:3. To make matters worse,
11 the billion dollars that the City would have owed CalPERS if it voluntarily withdrew would have
12 been due *immediately*. *Id.* at p. 191:21-23 ("When an employer terminates and we calculate how
13 much is owed at termination, *we seek these funds immediately.*") (emphasis added). The irony of
14 the Objectors' proposal that the City withdraw from CalPERS becomes more pronounced given
15 that state law would have required the City to pay CalPERS the \$1 billion before paying the
16 Objectors a penny. *See* Cal. Gov't Code § 20574 (the CalPERS board "shall have a lien on the
17 assets of a terminated contracting agency, *subject only to a prior lien for wages*" in an amount
18 equal to the termination liability) (emphasis added).

19 Second, this termination liability would be even larger if the City did not voluntarily
20 withdraw from CalPERS, a process that takes at least a year. *See* Cal. Gov't Code §§ 20570,
21 20572. If a contracting agency does not give CalPERS advance notice of at least one year before
22 withdrawing from the CalPERS system, and instead opts to unilaterally reduce or halt its
23 payments, CalPERS can terminate its contract with the agency. *See id.* This termination process
24 can take as few as 90 days. Cal. Gov't Code § 20572(a). Upon unilaterally terminating a
25 contracting agency, CalPERS has a statutory right not only to the termination liability, but also to
26 interest on the unpaid bills, to collection costs, to legal fees, *and* to delinquency penalties from the
27 contracting agency. *See* Cal. Gov't Code §§ 20572(b), 20574. Thus Stockton would be facing a
28 CalPERS bill well north of \$1 billion dollars had it simply halted or reduced payments without

1 one year's notice of its intent to withdraw. And either way (voluntary or involuntary), it would
 2 have been barred from entering into a new CalPERS contract for a full three years. *See* Cal.
 3 Gov't Code § 20460.

4 To summarize, the Objectors propose that the City should have ended its relationship
 5 with CalPERS only to face an immediate payment demand of almost \$1 billion in cash secured by
 6 a priming lien. It's a good plan if the idea is to shove the City into chapter 9 even faster.
 7 Obviously it was not bad faith for the City not to go this route, the Objectors' remonstrations to
 8 the contrary.¹⁵

9 This discussion also highlights the great irony of the objections to eligibility: the
 10 Objectors say that the City was not eligible because it did not address its pension liabilities during
 11 the AB 506 process. But what they really want the City to do—escape the strictures of state law
 12 and CalPERS—is *only* feasible (if feasible at all) within a chapter 9 case. Like Assured with
 13 respect to insolvency, the Objectors argue that the City should have done outside of bankruptcy
 14 what it could do only inside bankruptcy (if then).

15 (3) **Electing Not to Unilaterally Modify Pensions or to**
 16 **Further Reduce Wages and Benefits Did Not**
 17 **Demonstrate a Lack of Good Faith**

18 Since nothing was to be gained by negotiating directly with CalPERS in the AB 506
 19 process, it is unclear exactly how the City was supposed to reduce its pension obligations to
 20 retirees and employees without running afoul of the termination liability, and how therefore it was
 21 not in good faith for not doing so. The only cognizable theory the Objectors might assert is that
 22 the City somehow lacked good faith by not seeking more concessions in the AB 506 process from
 23 its retirees and employees. Indeed, the lurking subtext in the Objectors' pension discussion is that
 24 the City's Ask of labor "did not go nearly far enough." Assured Obj. 2. If that is their theory, it
 25 will fail. A municipality cannot be found to lack good faith when it chooses not to lower its at-

26 _____
 27 ¹⁵ Assured's suggestion that the City simply "terminate [its] contract and transfer its plan assets and liabilities to the
 28 terminated agency pool" is a red herring. Since the terminated agency pool has a total value of approximately \$90
 million, Hile Reply Decl., Ex. T, pp. 107:19-108:6, Stockton with its \$1 billion unfunded liability would effectively
 become the terminated agency pool.

1 market labor costs to below market, particular when the undisputed evidence suggests that doing
2 so would endanger the health and safety of the City's residents.

3 While the Objectors fairly point out that the City's labor costs were historically high, the
4 City has brought down its employee compensation packages to the point that, following the Ask
5 and the deals that followed it, the total compensation of the City's employees now falls at about
6 the median or even below the median when compared to that of similarly situated workers in
7 comparable cities. Goodrich Reply Decl., ¶¶ 8-11. This result was consistent with the City's goal
8 in the Ask of obtaining savings while maintaining compensation and benefits "competitive within
9 the market in order to recruit and retain employees." Millican Decl., Ex. A, p. 20; Goodrich
10 Decl., ¶ 8. While Assured makes noises about the City's use of a competitive market/comparable
11 cities methodology in setting compensation, its own experts recognize that this method is
12 standard practice among California cities, including those managed by Bobb. Hile Reply Decl.,
13 Ex. F, pp. 234:11-235:9 (Brann testifying that comparable cities methodology is "common
14 practice" in California); Hile Reply Decl., Ex. A, pp. 161:3-162:15 (Bobb describing market
15 surveys as "a standard part of [labor] negotiations").

16 The effect on individual employees of four years of pay reductions has been stark. *See*
17 Hile Reply Decl., Ex. U, p. 118:6-13 (up to 30%); Goodrich Decl., ¶ 9; Goodrich Reply Decl., ¶¶
18 9-11 (20-24% reduction in pay from 2008 to 2012). And unsurprisingly, these pay cuts, when
19 combined with staffing reductions and an escalating violent crime rate, have prompted an
20 increasing number of police officers to leave Stockton. *See* Jones Decl., ¶ 15; McCrary Decl.,
21 Ex. B, ¶¶ 17-18, 21-22, 58-59; Neumark Decl., Ex. B, p. 7. The Police Department also has had
22 difficulty in filling its budgeted positions. Jones Reply Decl., ¶¶ 7-9. In particular, it has been
23 nearly impossible to find qualified lateral candidates willing to work in Stockton. *Id.* ¶ 12. Based
24 on his knowledge of the department and the labor market, Chief Jones has expressed his concern
25 that "reducing total compensation and benefits to below market rates has already resulted in and
26 would continue hasten the departure of employees to other police departments." Jones Decl., ¶
27 15.

28

1 When compiling the Ask, the City knew that: (1) police sworn staffing was down 25%
2 from a few years ago, resulting in lower service delivery to the community, Jones Decl., ¶¶ 5-6;
3 (2) transfers away from Stockton were up, Brann Decl., Ex. B, pp. 15-16; (3) it was nearly
4 impossible for the Police Department to recruit a sufficient number of qualified lateral candidates,
5 Jones Reply Decl., ¶ 12; (4) its proposed reductions would bring the officers down to market pay
6 or even below, Goodrich Reply Decl., ¶¶ 8-9; (5) continuing to depress police salaries and
7 benefits increased the likelihood of officers seeking employment elsewhere, McCrary Decl., Ex.
8 B, ¶ 12; (6) a CalPERS defined benefit pension was the industry standard for police officers in
9 California, Deis Reply Decl., ¶ 39; and (7) while staffing was down, Stockton's violent crime and
10 murder rates had been rising, McCrary Decl., Ex. B, ¶¶ 17-18, 58-59; Jones Reply Decl., ¶¶ 3-4.
11 Indeed, on February 28, 2012, the City Council found that:

12 While any risk to the City's ongoing ability to provide necessary
13 public safety services to its citizens is a grave concern, the current
14 level of crime in Stockton makes this risk one that this Council is
15 unwilling to incur. To place at greater risk the safety of the
community in this time of greatest need would be an
unconscionable dereliction of this Council's most basic obligation
to its citizens.

16 Montes Decl., Ex. R, Section 1(h). Under these circumstances, electing not to bring
17 police salaries and benefits to below market (whether by pension reductions or some other way)
18 was not a lack of good faith. Given the possibility that such measures might well lead to the
19 departure of more officers, it was necessary to maintain the health and safety of the community.

20 While the Objectors disagree, they do not dispute any of the City's evidence or offer any
21 alternative evidence. Rather, they criticize the insolvent City for not commissioning a \$500,000
22 study to "prove" that further wage cuts actually would cause officers to leave. They also contend
23 that: (1) further wage reductions (whether as wage or as pensions, however that would work)
24 would not necessarily spark a "mass exodus" of employees; (2) the City has no difficulty
25 recruiting or retaining officers; and (3) further departures from the Police Department will not
26 harm the community, because to the Objectors there is no correlation between the number of
27 police officers a city has and its crime rate.

28

1 The Objectors leave the Court with a stark but easy choice. Either (1) the City was
2 negotiating in good faith by not seeking deeper labor cuts in the Ask where the evidence indicated
3 that further reductions in police pay risked causing additional officers to remove themselves from
4 the streets of one of the most dangerous cities in the country, where the Objectors' police expert
5 agreed that he would have "serious concerns" about losing officers if he were in Stockton's
6 situation, and where the City Council determined that "to place at greater risk the safety of the
7 community in this time of greatest need would be an unconscionable dereliction of this Council's
8 most basic obligation to its citizens," or (2) the City was not negotiating in good faith because it
9 neglected to complete a \$500,000, six-to-twelve month study to validate its assessment. The
10 choice is clear, and the answer is obvious. Refusing to risk the lives of its citizens cannot be a
11 lack of good faith.

12 (a) **The Only Evidence Demonstrates That Further**
13 **Wage Cuts Risked Provoking Officer Departures**

14 Impairing CalPERS pensions or otherwise lowering police compensation much below
15 market rates presented a risk to the health and safety of its citizens, a risk the City was not willing
16 to take when it prepared the Ask. That risk lies in the City's rational prediction that impairing
17 CalPERS could result in a mass exodus of experienced officers and exacerbate police recruitment
18 problems in a city that needs experienced, high-quality police officers. Jones Reply Decl., ¶ 5.
19 The Objectors' policing expert and the City agree that Stockton is a dangerous city. Declaration
20 of Joseph E. Brann [Dkt. No. 643] ("Brann Decl."), ¶ 5. As a dangerous city, Stockton needs
21 police officers. University of California, Berkeley crime policy expert and labor economist, Dr.
22 Justin McCrary, co-authored a study in 2013 of 242 U.S. cities naming Stockton the second most
23 under-policed city in California with a population greater than 200,000, as of 2010. Declaration
24 of Justin McCrary ("McCrary Decl."), Ex. B, ¶¶ 14, 63. McCrary has since updated his
25 calculations for 2011, and now ranks Stockton as the number one most under-policed city in
26 California with a population exceeding 200,000, surpassing the former industry leader, Oakland.
27 McCrary Decl., Ex. B, ¶¶ 63, 65, 67.
28

1 The City's prediction that impairing pensions would adversely affect its Police
2 Department was not conjured up by an academic in an ivory tower or a consultant who has not
3 worked in a police department for nearly 20 years. Rather, the prediction came from facts at
4 ground zero where the results of an incorrect decision would be felt. Chief Jones saw 27 of his
5 officers transfer to other police departments in the first nine months of 2012, triple the number of
6 officers who transferred out through all of 2011. Brann Decl., Ex. B [Dkt. No. 644], p. 16. Chief
7 Jones interviewed these officers, something neither of the Objector experts did. Hile Reply Decl.,
8 Ex. U, pp. 113:13-114:24; Jones Reply Decl., ¶ 13. In the interviews, these officers told him the
9 reasons they were leaving, and each officer cited the cuts in compensation and benefits that have
10 been inflicted on the Stockton Police Department since 2008 as motivating their departures.¹⁶
11 Hile Reply Decl., Ex. U, p. 118:14-17 ("But they couldn't . . . stay any longer because of the cuts
12 that have been imposed on them, and there were too many other agencies out there that would for
13 less work give them more pay"); Jones Reply Decl., ¶ 13. The cuts in compensation and benefits
14 have been painful and material, reaching up to 30% of total take-home pay for some officers.
15 Hile Reply Decl., Ex. U, p. 118:6-13; Goodrich Decl., ¶ 9; Goodrich Reply Decl., ¶¶ 9-11. In
16 addition, Stockton police officers have seen a 25% reduction in budgeted sworn officers since
17 2008, Jones Decl., ¶¶ 5-6, a move that has left the same work to be done by 25% fewer officers,
18 as well as a proposal in the Ask to completely wipe out retiree medical benefits. Millican Decl.,
19 Ex., p. 41.

20 Given these blows to the Police Department, the massive lateral departure number that
21 coincided with them, and the inability of the Police Department to fill even its budgeted officer
22 positions, it was no leap in deductive reasoning for the City to predict a fourth blow in the form of
23 an unprecedented reduction in pension benefits for current officers could result in a mass
24

25
26 ¹⁶ Brann expressed skepticism regarding the content of these interviews, and opined that interviews taking place
27 several months after an officer departs, when he or she has gained stability at his or her new job, would be more
28 trustworthy. Hile Reply Decl., Ex. F, p. 132:9-22. Chief Jones, in fact, followed up several months later, with
officers he previously interviewed. Jones Reply Decl., ¶ 14. For example, on January 23, 2013, Chief Jones spoke
individually with six of the officers who left in the first nine months of 2012. *Id.* Each reiterated that the primary
reason he or she left was the reductions in pay and benefits. *Id.*

1 exodus.¹⁷ Indeed, Brann and Neumark agree that there is some ultimate pay or benefit cut that
 2 will push an officer over the edge and force him or her to quit. Hile Reply Decl., Ex. F, p. 89:2-9
 3 (Brann testifying that “if you keep changing the numbers, there’s ultimately going to be some
 4 level that you could say this will absolutely do it.”); Hile Reply Decl., Ex. V, pp. 31:25-32:12.

5 The Objectors’ experts call the City’s claims regarding the risk of impairing CalPERS on
 6 its police department unfounded, criticizing the City’s evidence as “anecdotal” and “casual.”
 7 Declaration of David Neumark [Dkt. No. 637] (“Neumark Decl.”), Ex. B, p. 6-7; Brann Decl., Ex.
 8 B, p. 1. However “anecdotal” the City’s evidence, it is the only evidence before the Court. Both
 9 Neumark and Brann admitted that their reports do not assess the potential effect of a pension
 10 reduction on officer retention and recruitment in context. Hile Reply Decl., Ex. V, pp. 170:3-13;
 11 171:13-17 (“I [Neumark] was trying to focus on that [proposed or prospective cut in pension] *in*
 12 *isolation*. . . I’m not thinking of my opinion as what is the combined effects of all the stuff or
 13 even just all the things that are going to pertain to Stockton trying to resolve its fiscal situation.”);
 14 Hile Reply Decl., Ex. F, p. 63:2-13; 104:23-105:3; 91:21-25; 106:9-15 (Brann asserting he
 15 understood the City to believe a “single event” of pension reductions would trigger a mass
 16 exodus, and that he did not consider past wage or benefit reductions, cuts to staffing, or the City’s
 17 proposal to eliminate retiree medical benefits in formulating his opinions). When asked to assess
 18 the potential effect of a pension reduction on officer retention and recruitment in the real world—
 19 that is, in conjunction with the pay and benefit reductions since 2008, the 25% reduction in force
 20 since 2008, and the proposal to eliminate retiree medical benefits—Brann admitted it would be
 21 “foolish” for the City *not* to be concerned about what even a “modest” pension benefit reduction
 22 might do to the Stockton police force.¹⁸ Hile Reply Decl., Ex. F, pp. 126:12-127:13 (confirming
 23 that a reasonable police chief faced with a situation like Stockton’s would have “serious concerns
 24 regarding the effect any further reduction in benefits could have on [his] ability to retain []
 25 officers”). Neumark, too, admitted it would be reasonable for the City to question reducing

26 _____
 27 ¹⁷ Jones also spoke with several of his current officers, many of whom told him they would leave the Department if
 another cut to pay or benefits occurred, no matter how slight. Jones Reply Decl., ¶ 15.

28 ¹⁸ Brann admits to not even being aware of the City’s proposal to eliminate retiree medical benefits when he sent his
 report to Assured. Hile Reply Decl., Ex. F, p. 91:14-20.

1 pensions, when asked to consider such a reduction in context and not in a vacuum. Hile Reply
2 Decl., Ex. V, pp. 119:25-121:12.

3 (b) **The Objectors' Critiques Of The City's Evidence**
4 **Are Unfounded And Unreasonable.**

5 After these admissions, the relevance of Neumark and Brann's opinions on the potential
6 effect of "modest"¹⁹ pension reductions on officer retention and recruitment given the City's
7 evidence becomes questionable at best. Even assuming their opinions on this subject still merit
8 the Court's attention, their opinions lack any firm footing in fact, theory, or law, and should be
9 rejected.

10 The Objectors' experts provide four reasons why they are unconvinced by the City's
11 stated rationale for its CalPERS decision. First, both Neumark and Brann posit that officers have
12 been departing Stockton for "lifestyle reasons," and not monetary reasons as Chief Jones testified.
13 Neumark Decl., Ex. B, p. 8; Brann Decl., ¶ 7. Neither Neumark nor Brann has a shred of
14 evidence to support this speculation. Both admitted to having never interviewed a single current
15 or former Stockton police officer. Hile Reply Decl., Ex. V, p. 238:20-24; Hile Reply Decl., Ex.
16 F, p. 134:5-9 (Q: "[Y]ou haven't spoken to any of the officers who have left the department . . . is
17 that correct?" A [Brann]: "That's correct."). Furthermore, their lifestyle theory and the cherry-
18 picked literature Neumark uses to back it up is contradicted by more persuasive and
19 contemporary economic research, which says monetary prospects influence employee migration
20 to a substantial degree. McCrary Decl., Ex. B, ¶¶ 40-41.

21 Second, Neumark is not persuaded by the City's claims because they are not supported by
22 "recognized social science standards of evidence." Neumark Decl., ¶ 6. In so doing, Neumark
23 introduces a standard that no court has required a municipality to meet in order to be eligible for
24 bankruptcy. In his deposition, Neumark explained how the City could have supported its claims
25 in the court of social science when he explained how *he* would have gone about answering the
26

27 ¹⁹ Brann admitted Assured asked him to assume a "modest" pension reduction meant a 10% reduction, which Brann
28 interpreted to apply "across-the-board." Hile Reply Decl., Ex. F, pp. 77:22-24, 78:15-18. Brann hasn't the slightest
idea how such a reduction would be implemented in practice. *Id.* at pp. 226:13-227:4. Neumark defined "modest"
for himself as 10% plus or minus 7% "or a little more." Hile Reply Decl., Ex. V, p. 150:8-15.

1 question of what level of pension reductions would cause a “mass exodus” of experienced
2 officers or recruitment problems. Hile Reply Decl., Ex. V, pp. 89:14-90:20; 166:19-167:4. He
3 would have conducted a study, which he estimated would take six months of full-time work by
4 him and a support team (or twelve months if he kept his day job) and funding of “half a million
5 [dollars] or more.” *Id.* at pp. 96:26-97:6; 97:7-14. Neumark cautioned, however, that this study
6 might be impossible to complete because completing this study would require data that tracked
7 the migration responses of public sector workers—ideally police officers—to pension cuts. *Id.* at
8 pp. 94:20-95:8; 97:15-98:16. After all, according to Neumark, “[i]t may seem like stating the
9 obvious, but the only type of evidence based on past behavior that could predict future responses
10 to pension cuts would be past evidence on pension cuts.” Neumark Decl., Ex. B, p. 16. Of
11 course, he does not have such evidence. Nor does he even know if such evidence exists. *Id.* at
12 pp. 97:15-98:16; 168:24-169:9.

13 Had Neumark’s year-long \$500,000 study been conducted, it would have provided him a
14 model through which he could determine an approximate likelihood an officer would leave the
15 Stockton Police Department given an inputted level of pension reductions and other variables.
16 Hile Reply Decl., Ex. V, pp. 218:22-219:6. He does not know what this model would say, but
17 simply predicts—without any evidence of his own that stands up to “recognized social science
18 standards”—that a “modest” pension benefit reduction would not result in a “mass exodus” of
19 experienced police officers or recruitment problems. *Id.* 221:7-14.

20 Third, Brann opines that the City’s claims regarding its CalPERS decision are
21 unsupported by its evidence because the Police Department’s lateral transfer rate is “consistent
22 with” lateral transfer rates in California and “elsewhere.”²⁰ Brann Decl., ¶ 8. This argument is
23 now moot, because Brann struck lines from his report during his deposition. Hile Reply Decl.,
24 Ex. F, pp. 228:10-15, 229:22-230:1, 230:10-22, 231:6-12. In his deposition, Brann admitted that
25 the data he cited in his report, which he presented as lateral transfer rates from Florida, Alaska,

26
27 ²⁰ Given his lack of Stockton-specific and policing-specific experience, it perhaps unsurprising that the career
28 academic had “no basis for knowing whether [he] was looking at something highly unusual or not” when attempting
to assess whether Stockton’s lateral transfer rate data was consistent with “other departments or other years.” Hile
Reply Decl., Ex. V, pp. 86:9-87:14.

1 North Carolina, and Vermont, were in fact “overall attrition” numbers rather than lateral transfer
2 numbers. *Id.* at p. 230:17-22. Not wanting to “mix[] apples and oranges” or provide a
3 “misleading” statement of fact, Brann chose to strike these references from his report. *Id.* at
4 230:12-22. As a result, there is no evidence in the record as to lateral transfer rates “elsewhere”
5 that the Court can compare to Stockton’s. All that is left is the California Peace Officer Standards
6 and Training study cited by Brann, and it presents 21 years of annual California lateral transfer
7 rates, which during the 21-year period never exceeded 4.7%. Brann Decl., Ex. B, p. 16; McCrary
8 Decl., Ex. B, ¶ 19. By Brann’s own calculations, Stockton’s 2012 lateral transfer rate in its first
9 nine months was 8.1%. Brann Decl., Ex. B, p. 16. Thus, Brann strains reason in arguing
10 Stockton’s lateral transfer rate is “consistent with” California rates.

11 Fourth, both Neumark and Brann discount the City’s recruiting difficulties in arguing that
12 the City cannot support its claims regarding the potential effect of impairing CalPERS. Neumark
13 Decl., Ex. B, p. 19-20; Brann Decl., Ex. B, p. 16-17. In setting forth this argument, both rely
14 upon the number of applicants to the Stockton Police Department in 2011 and 2012. *Id.* They
15 both miss, however, a fact that Chief Jones knows is the truth: the number of applicants does not
16 matter if none are qualified. Jones Reply Decl., ¶¶ 8, 12.²¹ Indeed, it is no secret that despite the
17 number of applicants to the Stockton Police Department over the past two years—which is not as
18 high as Neumark and Brann think²²—the department still cannot fill its budgeted sworn officer
19 positions. Jones Decl., ¶ 6; Jones Reply Decl., ¶ 9. Chief Jones attributes this to low quality
20 applicants, many of whom cannot pass a background check or are running from problems in other
21 departments. Jones Reply Decl., ¶¶ 8-9. He also attributes this problem to constant attrition,
22 even involving new officers. *Id.* Thus, the City is justified in claiming that the uncertainty over
23 pensions and the past and proposed cuts in pay and benefits are affecting recruiting, and are
24 grounds for predicting the likely effect on recruiting of a pension reduction.

25 ²¹ Indeed, Neumark admits he has no idea how many applicants it takes to fill a single police position. Hile Reply
26 Decl., Ex. V, p. 231:10-17. This is not surprising given he has never worked for a police department. *Id.* at p. 39:13-
15.

27 ²² Neumark and Brann both cite to a news article reporting 1,300 applicants attended a Stockton Police Department
28 physical agility test. Neumark Decl., Ex. B, p. 20-21; Brann Decl., Ex. B, p. 18. In reality, 1,300 is simply the
number of applicants that RSVP’d. Jones Reply Decl., ¶ 10. Less than half that number actually showed up for the
test. *Id.*

1 Assured actually suggests the City solve its recruiting problems by hiring from its large
 2 pool of unemployed citizens, in effect criticizing Chief Jones and the Police Department for not
 3 lowering the City's standards. Assured Prelim. Obj. 6 ("although the City argues it cannot extract
 4 more from labor because it must 'remain competitive,' such an assertion defies common sense in
 5 a City with an unemployment rate that, based on the City's own estimations, is as high as 20%.").
 6 This position highlights Assured's indifference about the health and safety of the residents and
 7 businesses of Stockton. A city with Stockton's crime rates cannot have just anyone off the street
 8 protecting it; Stockton needs quality officers.²³

9 (c) **The Objectors Distort The Grave Reality Of**
 10 **Crime And The Need For Officers In The City.**

11 Brann attempts in three ways to minimize the City's concerns about the potential public
 12 safety consequences of impairing CalPERS. First, he cherry-picks data to argue that crime is
 13 declining in Stockton, manufacturing an alternate reality in which the City's public safety
 14 concerns are overblown. Brann Decl., Ex. B, p. 4-5. Second, he maintains that there is no causal
 15 relationship between officers-per-capita and crime, in effect stating that it does not matter
 16 whether Stockton can hire and retain the number of police officers Chief Jones, the City Council,
 17 and City staff think it needs. *Id.* p. 7. Third, he claims there is no evidence linking officer
 18 experience to officer effectiveness, thereby attempting to preempt any concern about the fact that
 19 the City is being protected by an increasing number of rookie officers. *Id.* at 19-20. Each of
 20 these arguments lacks merit and should be rejected.

21 In arguing that Stockton's crime rates are declining, Brann uses baseline dates in the early
 22 1990's without any principled justification besides a stated desire to draw a trend line. Brann
 23 Decl., Ex. B, p. 4-5; Hile Reply Decl., Ex. F, pp. 189:11-21. He fails to mention that in the early
 24 1990's, crack-cocaine gang wars were occurring, which makes it entirely inappropriate to
 25 compare crime from that period to the present. Jones Reply Decl., ¶ 3. If Brann had chosen a

26 _____
 27 ²³ In his report, McCrary discusses what happened in Washington, D.C. in the late 1980s and early 1990s when it
 28 lowered its standards to hire more police officers. McCrary Decl., Ex. B, ¶¶ 25-27. The results were disastrous in
 terms of the quality of police work and the exorbitant expenses incurred replacing many of the low-quality officers
 who had to be fired. *Id.*

1 year after the early 1990's as a reference, such as 2007 or 2008, he would have seen that crime
2 rates in Stockton are on the rise in many key crime categories such as murder. *Id.* ¶ 4; McCrary
3 Decl., Ex. B, ¶ 58. Additionally, if he looked at Stockton's crime rates in comparison to other
4 California cities, he would have seen that Stockton crime rates are increasing while crime rates in
5 other California cities are staying flat or decreasing. McCrary Decl., Ex. B, ¶¶ 58-59.

6 As to Brann's argument that there is no causal relationship between officers-per-capita
7 and crime, peer-reviewed research in criminology and economics spanning multiple decades begs
8 to differ.²⁴ *Id.* ¶¶ 50-53. In a 2013 study based on 1960-2010 data, McCrary, building upon
9 decades of research on the causal relationship between officers-per-capita and crime, analyzed
10 242 U.S. cities and empirically measured the reduction in the cost of crime in a city for every
11 additional dollar spent on policing. *Id.* ¶¶ 14, 63. McCrary concluded that Stockton was under-
12 policed in 2010 because each additional dollar spent on policing would have saved the City \$2.30
13 in crime costs. *Id.* Upon ranking the most under-policed cities, McCrary found that Stockton was
14 second only to Oakland in 2010 among California cities with populations greater than 200,000.
15 *Id.* McCrary re-calculated his rankings for 2011 and found that Stockton surpassed Oakland, and
16 is now the most under-policed city in California with a population greater than 200,000, and that
17 each additional dollar spent on policing would save the City more than \$3.00 in crime costs.²⁵ *Id.*
18 ¶¶ 14, 63, 67. This finding is completely consistent with the report prepared by Harvard
19 consultant Anthony Braga in 2006, Jones Decl., ¶¶ 3-4, and with the results of another recent
20 report commissioned by the City, Jones Reply Decl., ¶ 18 & Ex. B, pp. 28-29.

21 Finally, Brann cannot be trusted in his attempt to reassure the City that rookie police
22 officers will be just as effective as the experienced officers it stands to lose if it impairs CalPERS.
23 As an initial matter, Brann, himself, backtracked on this position in his deposition, and even
24 wavered on it in his report. Hile Reply Decl., Ex. F, pp. 146:1-3 ("the younger officers, the

25 ²⁴ Even putting aside the debate on the causal relationship between cops and crime, Brann agrees with the City that
26 every police department needs a minimum number of officers to function. Hile Reply Decl., Ex. F, pp. 170:24-171:9.
27 He does not know if the City is near its floor, but evidence on Stockton's escalating crime rates, McCrary Decl., Ex.
28 B, ¶ 59, and the safety services it can no longer provide to the City, Jones Decl., ¶ 8, suggest it is.

²⁵ McCrary predicts these numbers will only grow more extreme when complete data for 2012 become available and
he is able to update his findings, given Stockton's high 2012 crime rates relative to other California cities. McCrary
Decl., Ex. B, ¶ 67.

1 rookie officers, clearly are not where you want them to be yet”); 152:11-18 (admitting that if a
 2 city was starting a new police agency “from scratch” it should not simply hire all inexperienced
 3 personnel as officers); Brann Decl., Ex. B, p. 12 (“[T]he departure of 21 officers with 10+ years
 4 of experience to other agencies over a five year period is a source of concern . . .”).

5 Furthermore, Chief Jones, someone intimately familiar with the criminal and policing history of
 6 Stockton unlike Brann, forcefully disagrees with Brann on this issue. Jones Reply Decl., ¶ 19.
 7 Chief Jones maintains that Stockton needs many more experienced officers given its current and
 8 historical crime profile. *Id.* ¶¶ 5-9. According to Chief Jones, a police force with too many
 9 inexperienced officers presents a danger to both the public and the officers, given that they are
 10 more likely to be assaulted on the job, to get into car chases and crashes, and to be involved in
 11 cases that are thrown out of court due to issues such as mishandling of evidence. *Id.* ¶ 19.

12 In sum, despite Brann’s contentions to the contrary, the City’s public safety concerns are
 13 very real, and it acted in good faith by averting the risk of mass exodus of experienced officers by
 14 not attempting to impair CalPERS or otherwise reduce wages and compensation more than called
 15 for in the Ask.

16 **d. No Conflict Of Interest “Tainted” The Ask.**

17 National argues that the City’s decision not to impair CalPERS was “tainted by self-
 18 interest” because the members of the City’s team making that decision owned CalPERS pensions.
 19 National Obj. 7. This character assassination merits little attention.

20 First, when it was discovered that, through administrative error, several members of the
 21 City Council were accruing pension benefits, the Council immediately stopped the practice when
 22 it came to light, and the accrued pension benefits reverted to the City. *See* Michael Fitzgerald,
 23 *City Has Been Paying Illegal Benefits For Years*, STOCKTON RECORD, Apr. 25, 2012.

24 Moreover, even if *every* member of the City Council had CalPERS benefits, California
 25 law expressly authorizes government officials—like the City Council members and senior staff—
 26 to make decisions affecting pension benefits. *See* Cal. Code Regs., tit. 2, § 18232(a) (defining
 27 terms in Cal. Gov’t Code §§ 87100, 87103, 82030(b)(2)); *see also* 85 Ops. Cal. Atty. Gen. 6,
 28 2002 WL 32457 (Cal. A.G., Jan. 10, 2002) (concluding that a city council member may

1 participate in the making of a contract between his city and another city for law enforcement
2 services where he was a retired police officer previously employed by the other city and was
3 currently receiving CalPERS health benefits from the other city). Such express authorization is
4 not surprising given the pervasive and compulsory nature of CalPERS pension benefits in
5 California, and the unreasonable burden as to government decision-making an alternative rule
6 would create. *See* Cal. Gov't Code §§ 20502, 20281 (membership in CalPERS is compulsory for
7 all employees of a CalPERS jurisdiction).

8 No objective bystander would view the City's decision-makers as acting in their own self-
9 interest over the last few years. City leaders have recommended many cuts to their own wages
10 and benefits, including complete elimination of the retiree medical benefit. *Deis Reply Decl.*, ¶ 7.
11 In addition, the City, upon making its CalPERS decision, firmly and rationally believed that
12 impairing CalPERS would materially harm the retention and recruitment efforts of its police force
13 and thereby exacerbate Stockton's climbing and already-staggering crime rates. *See supra*
14 Section III(D)(1)(c)(3). National strains reason by alleging that City officials acted in their own
15 self-interest by steering clear of these two threats, but then illogically impairing their most
16 expensive benefit: free health care for life.

17 Indeed, it is the City officials' lack of personal interest in the CalPERS decision that
18 distinguishes this case from the conflict-of-interest cases cited by National. National Obj. 7-9. In
19 each of those chapter 11 conflict of interest cases, the debtors' or plan proponents' interests,
20 unlike the interests of the City's decision-makers, were personal. *In re Am. Capital Equip., LLC*,
21 668 F.3d 145, 156 (3d Cir. 2012) (debtor's plan financially incentivized the debtor to sabotage the
22 defense of asbestos claims asserted against it); *In re Coram Healthcare Corp.*, 271 B.R. 228, 232
23 (Bankr. D. Del. 2001) (debtors' chief restructuring officer received \$1 million per year under a
24 separate employment agreement with one of the debtors' largest creditors); *In re Unichem Corp.*,
25 72 B.R. 95, 100 (Bankr. N.D. Ill. 1987) (plan allowed individual who breached his fiduciary duty
26 and caused the debtor's financial distress to utilize the Bankruptcy Code to drive a competitor out
27 of business). Here, City officials made a decision that they felt was for the best of the people of
28 the City of Stockton.

1 National also cites one corporate acquisitions conflict-of-interest case, *Mills Acquisition*
2 *Co. v. Macmillan, Inc.*, 559 A.2d 1261 (Del. 1989). National Obj. 8-9. That case also involved a
3 truly personal conflict of interest, 559 A.2d at 1279-80, and the pertinent rule of the case compels
4 the Court to leave the City's CalPERS decision undisturbed. Under *Mills*, "directors are required
5 to demonstrate both their utmost good faith and the most scrupulous inherent fairness of
6 transactions in which they possess a financial, business, or other personal interest which does not
7 devolve upon the corporation or all stockholders generally." 559 A.2d at 1280. If a transaction in
8 which a director has a personal interest does in fact "devolve upon the corporation or all
9 stockholders generally," and the director informs him or herself of all material information
10 reasonably available bearing on the transaction, then the "business judgment rule" applies in the
11 appraisal of the director's decision. *Aronson v. Lewis*, 473 A.2d 805, 812-13 (Del. 1983). Under
12 the business judgment rule, the burden is on the party challenging the transaction to establish
13 facts indicative of "gross negligence," and the director's decision will be upheld "unless it cannot
14 be attributed to any rational purpose." *Id.* at 812-13; *In re Walt Disney Co. Deriv. Litig.*, 906
15 A.2d 27, 74 (Del. 2006).

16 This case is not like *Mills* in which the board of directors relied on the advice of someone
17 with a strictly personal financial stake in the outcome of the contested decision. *Mills*, 559 A.2d
18 at 1279-80. Here, the City's decision-makers, instead made a decision that "devolve[d] upon" the
19 equivalent of their "corporation and stockholders" because their decision was made for the benefit
20 of the people of Stockton and did not exclude the other approximately 1,400 City employees with
21 CalPERS pension benefits. The City's decision-makers also informed themselves of all material
22 information reasonably available to them bearing on their decision as evidenced by the Ask.
23 Thus, if the Court holds, as National insists it should, that *Mills* and corporate acquisitions
24 jurisprudence applies here, the City's CalPERS decision should be reviewed under the business
25 judgment rule. Because National has not established facts indicative of "gross negligence" or that
26 the City's decision had no rational basis, under the business judgment rule, the City's decision
27 should not be disturbed.
28

2. Alternatively, Negotiation With the City’s Creditors Was Impracticable (§ 109(c)(5)(C))

The Court need not even reach the question of whether the City negotiated in good faith with its creditors because such negotiations were impracticable. Mem. 40-41. As the City demonstrated, *Vallejo*, *Pierce County*, *Valley Health*, and *OTB*—which the Objectors do not even attempt to distinguish—dictate a finding of impracticability where the City was unlikely to achieve a successful restructuring because (1) the number of parties competing for too few dollars made it highly unlikely that a global restructuring plan would be achieved in a voluntary setting; and (2) the City could not bind its numerous retirees to any deal negotiated in the AB 506 process. *Id.* This is particularly true when the City’s financial creditors came into the process wondering upfront whether to “speak[] out about the absurdity of this proposal.” Hile Reply Decl., Ex. W. The likelihood of striking a comprehensive deal with such participants was low.

Amazingly, Assured contends that “the City cannot argue that it could not bind retirees to a modified retiree medical plan outside of a bankruptcy.” While the City can and has negotiated changes to active employees’ health benefits that affect retirees, no class mechanism exists to bind a single retiree to anything. In other words, if as part of the Ask the City had obtained 80% of what it wanted from, say, 200 retirees, nothing would bind the other 2,200 or keep them from suing it and possibly winning the lawsuit.²⁶ While Assured attempts to provide authority under which the City could have impaired retiree benefits without consequences, Assured Obj. 32-34, the fact remains that unilaterally reducing retiree benefits would have exposed the City to significant legal risk and potential damages running into the hundreds of millions. *See Retired Emps. Ass’n of Orange Cnty., Inc. v. County of Orange*, No. 12-56706 (9th Cir. Sept. 6, 2012); *Sonoma Cnty. Ass’n of Retired Emps. v. Sonoma Cnty.*, No. 10-17873 (9th Cir. Dec. 22, 2010).; Deis Reply Decl., ¶ 26.

///

²⁶ And had the City impaired pensions, as the Objectors urge it to, it would have had even more retirees with which to contend.

